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Estate and inheritance taxes are today a heavy charge upon the estate of a decedent. And provision for their discharge will necessarily be as varied as the assets of which the estate is constituted and as are the desires of the testator for disposition of property weighing the desires of the testator against the cost in terms of taxes that will fall due. That phase of planning as it affects the innumerable possibilities for minimizing the tax burden has been discussed.

Providing for the discharge of that burden is the next step in the planning. This takes the form of providing liquid assets by adding funds to the estate and by providing for conversion of existing assets. Then it is necessary to draft the provisions of trusts and wills to properly apportion the burden.

I. PROVIDING FOR LIQUID ASSETS

A. *Additional Funds*

When it is necessary or desirable to preserve the estate intact, providing additional funds in order to discharge the death tax may be utilized. This may be done by taking out additional insurance where the necessity is immediate, or a gradual investment program for this purpose may be adopted. Prime consideration must be given to the savings ability of client, the liquidity of the assets comprising his estate, his age, available investment media and other factors. Dollar and cents costs are also important and are illustrated here for consideration.

Additional funds by insurance or investment are necessarily placed in the top tax bracket of the estate. This cost should therefore be calculated. Approximate calculations for illustration of this factor follow:

Net Taxable Estate	Estate Tax	Estate Tax Rate on Additional Funds	Additional Funds Consumed by Taxes	Total Funds Required
$5,000,000	$2,500,000	75%	$7,500,000	$10,000,000
500,000	145,000	35%	80,000	225,000
250,000	65,000	32%	35,000	100,000

In addition to the tax cost, the choice of methods of providing additional funds will involve other monetary costs. There are many con-

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siderations in determining whether an insurance program, a program of other investments or a combination should be utilized. But consider the cost in terms of return on the dollar invested. The following table illustrates that return with respect to a man 40 years of age with a life expectancy of 30 years:

Net Annual Insurance Premium Per $1,000	Annual Investment to Provide Fund of $1,000 at end of 30 years — Compound Interest			Annual Cost Differential Per $1,000
	3%	4%	5%	
$22.71	$20.41			$2.30
$22.71		$17.14		$5.57
$22.71			$14.33	$8.38

Seldom will the estate plan call for additional funds alone. It will be so expensive that some shrinkage in the estate will have to be accepted. And thus we turn to conversion of existing assets into liquid form.

B. *Conversion of Assets*

Changing existing policies of insurance so as to be payable to the estate provides ready access to cash for the discharge of the tax burden. The $20,000 insurance exemption under North Carolina inheritance tax laws can be utilized and changes of policies above this amount will incur no additional tax cost. However, if the policies were taken out years ago, they will bear an unusually high return if the payment of the proceeds is made by other than a lump sum payment. So changing the beneficiary in such cases can be costly.

In providing tax funds by means of intervivos agreements for sale of business interests to business associates, the valuation of the interest to be sold is important so as to plan the amount of cash which will be available for discharge of the tax burden. Where the business interest is the major asset in the estate, the amount of estate tax will vary in proportion to the value of the business. But in any case if sale value can be tied to estate tax value the problem of anticipating cash requirements to pay the tax burden is aided. Where the sale price is fixed at a stated sum or by a particular formula in the contract and the contract is effective during lifetime to prevent sale to outsiders, the price as thus fixed will probably control for estate tax valuation purposes.[1] Thus the amount of cash available to pay taxes can be anticipated.

Where a spouse or other beneficiary has independent funds with

[1] See Gutkin and Beck, *Restrictive Stock Agreements and Estate Tax Minimization*, 25 TAXES 413 (1947).

which to take out insurance payable to herself, the proceeds can be excluded from the gross estate and assets retained in the family by purchase from the executor.[2] Because of fluctuation in the value of the business, frequent review of this program to fund the purchase must be made. The value fixed for estate tax purposes is suggested for use in the sale of an asset not subject to an intervivos agreement. One practical disadvantage in the use of estate tax valuation for sale price is the delay in final determination of that value and consequent sale. And often family businesses are overvalued for tax purposes. But such a value is more reliable than expert evaluation because it is fixed by negotiation between opposing interests. The general powers to compromise taxes and debts, continue operation of the business and borrow for the benefit of the estate that should be given to executors will provide for most contingencies. A special will provision to be added to the provision for general powers is set forth in the Appendix.[3]

One variation of the acquisition of cash from the surviving kin is the discretionary provision in trusts for purchase or exchange of assets. Where it is practicable to effect an irrevocable trust which is not included in the gross estate for estate tax purposes, the exclusion from the gross taxable estate will not be destroyed by such a provision for purchase or exchange.[4] And liquid assets are made available. A suggested Trust Provision is set out in the Appendix.[5]

If retention of a business in the estate is desired and payment of death taxes is also a problem, incorporation of the business before or after death and the sale of stock to managerial personnel are available methods. This is not too reliable a method of obtaining liquid assets after death unless coupled with some binding intervivos agreement. Managerial personnel can take out insurance on the life of the decedent to provide funds for the purchase of such an interest. But they will not ordinarily do so unless the decedent is bound by some intervivos agreement which gives them a small interest during the life of your testator and a larger interest upon his death. Incorporation prior to death would ordinarily be required to effect this objective. In such a case the will need only recite the execution of the agreement and direct the executor to comply with its terms without the necessity of an order of court.

On the other hand, your will provision is very important if incorporation after death is contemplated in order to permit latitude in adjusting the several interests in both capital and surplus and in voting

[2] See Morehead, *How Life Insurance Helps Conserve Estates*, 24 TAXES 663 (1946), reprinted from 20 FLA. L. J. 9 (1946).
[3] See App. A.
[4] Welch v. Hall, 134 F. 2d 366 (C.C.A. 1st 1943).
[5] See App. B.

control. No unusual income tax problems are ordinarily met in cases of incorporation after death of a sole proprietorship because the cost basis of the business to the estate is its value at death and ordinarily approximates the value upon incorporation; hence little gain if any could be recognized on the exchange of property for stock. But where the widow or other person has or acquires a tax recognized interest in the business, IRC §115 (b) may operate to tax a gain to the owners upon incorporation. And managerial personnel may have an income tax problem if they purchase a stock interest for a consideration substantially less than the value as determined for federal estate taxes. A provision for incorporation and sale of a business interest is set out in the Appendix, which may be as varied as the nature of the stock interest to be sold.[6] But the executor and/or trustee should be given as wide a discretion in working out the details of adjustment as possible. Clients cannot always be sold on corporate trust companies with wide discretionary powers but the more you can prevent the dead hand from reaching into the future to control the discretion of the executor or trustee, the better the estate will be administered.[7]

The method of providing for needed funds to liquidate the tax burden is inseparably tied up with the will provisions which allocate that burden, and that problem should next have our careful consideration.

II. Apportionment of Death Tax Burden

A. *Practical Need for Planning as to Tax Burden*

Perhaps one of the most important and yet least stressed phases of tax planning for estates is the provision for designating the property which shall be reduced by federal estate and state inheritance taxes. Proper attention must be given to the burden of the tax as between the interests of specific legatees, residuary legatees, insurance beneficiaries and beneficiaries of property not passing through the control of the executor but because of a retention of interest during life or a gift in contemplation of death, is nevertheless included in the gross taxable estate and gives rise to a death tax. Provisions for the payment of taxes in all wills affected by the Revenue Act of 1948 should be reexamined. And whenever any new tax is levied such as the proposed single transfer tax, those provisions should be revised or the courts will say that the particular tax was not contemplated by the will provision.[8] Furthermore where all these taxes are imposed on residue and the will is

[6] See App. C.

[7] For source material with respect to legal non-tax aspects connected with these problems see Cahn, *Estate Corporations*, 86 U. of Pa. L. Rev. 136 (1937); *The Bequest of a Business*, N.Y.L.J. (June 13, 1942); Scott, *Testamentary Directions to Employ*, 41 Harv. L. Rev. 709 (1928).

[8] See Notes, 116 A.L.R. 861 (1938), 51 A.L.R. 475 (1927).

not periodically reviewed in relation to the fluctuations in value of property interests prior to death, the residuary beneficiaries may suffer for the benefit of the specific legatees. Thus, in Mr. Wilson's estate of $500,000, he sets up a trust of $300,000 for his married children and gives his wife his business and the residue. At the time the business may be worth $100,000 and residuary stocks and bonds $100,000. Later the business may be worth $200,000 with very little residuary assets. If all taxes are to be paid out of residue, the widow will have to borrow against the business interest to pay these taxes. Is there any reason why the legacies to the children should not bear their share of the tax? On the other hand the failure to exempt certain legacies from the burden of death duties may cause the legacy to be a white elephant if the total estate is in high brackets and the proportionate part thereof must be "put up" by the legatee to prevent its liquidation to pay taxes. So we shall look at where the law places the death tax burden to see what adjustment should be considered in the will and trust.

B. *Tax Burden Under Federal Law*

The statutory provisions and effect thereof on the tax burden can be illustrated by showing the results where the will makes no provision whatsoever for the payment of death taxes. More often than not the draftsman who is not familiar with this subject will be better off, in North Carolina estates at least, if he just omits this clause. But no estate of a size requiring consideration of this problem should be planned without very careful drafting of this clause.

Where then is the burden imposed by federal law? Under the federal basic estate tax and additional estate tax, the burden of the tax falls upon the entire estate without apportionment. IRC §26 does not, as is commonly considered, impose the tax on any particular part of the estate. If there were no will provision or state general or statutory law, the executor could pay the federal estate tax out of any assets in his hands. Congress makes no attempt, in general, to allocate the burden of that tax but leaves the matter entirely to local law.[9] It is only interested that, until paid, the entire tax shall be a lien upon any part and all of the estate. And the executor is personally surcharged by the United States for distribution of assets without guaranteeing payment of those taxes.[10] The Treasury Department Regulations provide in Reg. 105 §§81-84 that the Commissioner cannot be compelled to apportion the tax among the persons liable or to enforce any right to reimbursement or contribution.

IRC §826 does provide a right of reimbursement of federal estate

[9] Edwards v. Slocum, 287 Fed. 651 (C.C.A. 2d 1923), *aff'd*, 264 U.S. 61 (1924); Riggs v. Del Drago, 317 U.S. 95 (1942).

[10] INT. REV. CODE §3192; see Riggs v. Del Drago, *supra* note 9.

taxes with respect to insurance not payable to the estate or to property passing under a power of appointment. In the absence of provision in the will and, it is believed, despite a contrary state law on the subject, the executor is compelled by federal law to seek reimbursement thereof to the general estate from the insurance benficiary and from the appointee of property passing under a power of appointment.

This right of reimbursement extends to the proportion of the total tax paid as the proceeds of insurance or value of property passing under the power bears to the entire net taxable estate and the exemptions. Where either the insurance or the property passing under a power qualifies for the marital deduction under the 1948 Act, that deduction is first applied against the insurance proceeds and then against the property under the power, and only the excess value of such property shall be subject to and be considered in the computation of the extent of this right of reimbursement. Take for example, an estate where the marital deduction was $100,000 and included in the gross estate there was $75,000 insurance payable to the widow and $50,000 property passing to the widow under a power of appointment exercised by the decedent. The marital deduction is first applied to the $75,000 insurance then the remaining $25,000 shall be applied with respect to the property passing under the power. Thus only $25,000 of the property passing under the power shall be considered in the proportion formula for computation of the percentage of the federal estate tax which is subject to be collected by the executor for reimbursement of the general estate.

In the absence of a specific provision in the will, all kinds of difficulties arise. The insurance companies take the position that they have no duties with respect to this right of reimbursement. Certainly the federal law imposses no obligation upon the insurance companies.[11] To date insurance companies have not been held liable where the proceeds have been paid to the beneficiary.[12] Where settlement options are in effect the right of reimbursement is obviously very difficult and it is an open question whether that right extends to proceeds held by insurance companies. So the provision for payment of taxes in a will is a matter of drafting and estate planning, the importance of which is not often stressed as it should be.

Now, in the absence of a provision in the will what does the state law provide? Recall that in many estates, the property of the decedent may be situated in various states. The laws of what jurisdiction apply as to the federal estate tax burden, the state death duties of the domicilary state and those of ancillary state or states?[13]

[11] See, Polisher, *Prorating the Federal Estate Tax Among Life Insurance Beneficiaries,* 24 TAXES 172 (1946); CCH FED. EST. & GIFT TAX REP. ¶3838.38.

[12] *In re* Estate *of* Palliser,—N.Y.S. 2d—(Sup. Ct. March 29, 1948); CCH FED. EST. & GIFT TAX REP. 10,164.

[13] See Karch, *The Apportionment of Death Taxes,* 54 HARV. L. REV. 10 (1940).

C. *Tax Burden Under State Law*

1. Apportionment Statutes

Some of the states have passed statutes dealing specifically with the apportionment of federal and state death duties. Discussions of the New York and Connecticut statutes appear in the January, 1945 and July, 1946 issues of the *Connecticut Bar Journal.*[14] The effect of these statutes is to supersede any other conflicting state law on the subject and operate only in the absence of adequate provision in the will. Briefly, these statutes in general provide for the pro rata charging of the taxes in the proportion that the particular property bears to the total value of the taxable estate. No apportionment is generally made as between life and remainder interests. But property not passing through the possession of the executor must bear its share by virtue of an obligation upon the executor to seek reimbursement. The following states in addition to New York and Connecticute have such statutes: Arkansas, California, Delaware, Florida, Kansas, Maine, Maryland, Massachusetts, Minnesota, New Hampshire, Pennsylvania, Rhode Island, Tennessee, Texas and Virginia.[15]

In the article by Francis P. Schiaroli[16] a splendid discussion of the effects of these statutes is had. To show the possible effect of apportioning taxes the author cites the case of a beneficiary receiving approximately $6,500 out of a $10,000 legacy by reason of the fact that the total taxable estate was large.

2. Other Statutory Provisions

Relying on these or any other statutory scheme is often hazardous because the testator may change his domicile and, absent a provision in the will, the burden may fall according to the law of another state. Since property interests may be located in more than one jurisdiction the statutes of all those states must be considered in the absence of a provision in the will. The right to apportion the burden is somewhat nebulously asserted on the right to tax. Actually jurisdiction to require contribution may depend upon either jurisdiction of the property or the beneficiary.[17] The statutory provisions of the states which have not adopted the so-called apportionment statutes may be classified as either placing the burden on residuary estates or on the succession to the property interest taxed. In the former all estate and inheritances

[14] See also Polisher, *Estate Tax Apportionment,* 84 TRUSTS & ESTATES 99 (1947).

[15] CCH FED. EST. & GIFT TAX REP. ¶3729.18; P-H WILLS, EST. & TRUST SERV. ¶2667.

[16] Schiaroli, *Apportionment of Federal and State Estate Taxes in Connecticut,* 20 CONN. B. J. 198 (1946), 24 TAXES 1086 (1946).

[17] *In re* Buckman's Will. 270 App. Div. 707, 62 N.Y. Supp. 337 (1st Dept. 1946); Matter of Bogart,—N.Y.S. 2d—(Sup. Ct. Jan. 2, 1947).

fall on the property not specifically bequeathed or devised. In the latter, the tax and its burden is imposed with respect to the particular property interest. States that are considered classed in the former category with respect to local taxes are: Alabama, Arizona, Georgia, Mississippi, Oklahoma, Utah. States in the latter category are; North Carolina, Colorado, District of Columbia, Idaho, Illinois, Indiana, Iowa, Kentucky, Louisiana, Michigan, Missouri, Montana, Nebraska, New Jersey, New Mexico, North Dakota, Ohio, Oregon, South Carolina, South Dakota, Vermont, Washington, West Virginia, Wisconsin, Wyoming. These statutory provisions do not as a rule provide for the burden of federal estate taxes nor are they specific as to the state estate tax levied pursuant to the 80% credit provisions.[18]

3. General Principles of Tax Burden

In the absence of statutory or will provisions, the incidence of the tax would presumably determine where the burden must fall.

Since the federal estate tax is a tax upon the transfer of property from the decedent irrespective of the interest of beneficiaries, it could be assumed that all of the property will bear its pro rata share of such tax. But that is not so. Residue to which the executor takes title and not specific bequests must bear the burden of federal estate taxes.[19] Where a will bequeaths and devises all the residue of property, both real and personal, the real estate is held to immediately pass to the beneficiary and federal estate taxes must be paid from residuary personalty without apportionment to realty.[20]

North Carolina has both an estate tax and a succession or inheritance tax. The former levies an estate tax designed to collect the difference between the inheritance taxes imposed by this state and the maximum credit of 80% of the federal basic estate tax.[21] The inheritance tax imposed by North Carolina is on the interest of each beneficiary to the extent of his interest and is therefore a succession tax and not an estate transfer tax. This being so, each beneficial interest in property is subject to the tax upon it.[22] And the executor shall not distribute the property without first deducting and paying or having the beneficiary pay the inheritance tax applicable to such property.

Where the burden of the North Carolina estate tax proving for

[18] See CCH INH., EST. & GIFT TAX SERV. ¶2030 as to each state.

[19] Y.M.C.A. v. Davis, 264 U.S. 47 (1924).

[20] Hepburn v. Winthrop, 83 F. 2d 566 (App. D.C. 1936); *See* Brown's Estate v. Hage, 198 Iowa 373, 199 N.W. 320 (1924); Chase National Bank v. Gaston, 51 N.Y.S. 2d 670 (Sup. Ct. 1944); Buffaloe v. Barnes, 226 N.C. 313, 38 S.E. 2d 222 (1946); see Note, 142 A.L.R. 1137 (1943).

[21] See Perkins, *The Federal Estate Tax Credit Clause,* 13 N. C. L. REV. 271 (1934).

[22] *In re* Morris Estate, 138, N.C. 259, 50 S.E. 682 (1905); *see In re* Borquin's Estate, 87 Col. 144, 286 Pac. 114 (1930).

80% credit and any tax upon intervivos transfers is intended to be imposed by the North Carolina Revenue Act is doubtful. N. C. GEN. STAT. §§105-7, 8 (1943) state the tax is against the estate and shall be paid out of the same funds as any other taxes against the estate. As it is a tax on the transfer from the decedent, it should be prorated among all property interests passing by reason of death; but probably falls upon the residuary estate under the principle of *Buffaloe v. Barnes*.[23]

As to intervivos transfers in the absence of specific statutory provision, the federal estate tax and the state estate tax cannot be imposed by will upon the property transferred.[24] The inheritance or succession tax is ordinarily imposed by statute upon the donee of such property. If the transfer is by way of a trust, the trust instrument should take care of both tax burdens. The tax burden on property held by an estate by the entirety, however, may be imposed on residue by a will or specific statutory authority.[25] With respect to the tax on interests transferred during life the will can charge it against the probate estate but not against property not under the control of the executor.

Under particular statutes requiring the tax to be paid from the property transferred, practical difficulties are met with respect to life annuities, life interests, and income interests. But the courts take a practical approach and assess the tax on both the life and remainder interest against the corpus.[26]

Other problems arise such as the placing of the burden of interest payable on delinquent payment of taxes which can frequently arise in cases where the executor must contest the amount of the tax burden.[27]

Thus it is seen that relying on general law without an adequate will provision is hazardous and shows an absence of estate planning.

D. *Will Provisions and the Tax Burden*

The importance of adequate provision in the will is therefore clear. So far as federal estate taxes are concerned, there is no question but that the provisions in the will control the rights of the executor and beneficiaries as between themselves.

It is generally assumed that the will provisions will also control over the North Carolina statutory scheme of imposing the tax burden. But the will provision must be clear and precise to overcome the presump-

[23] 226 N.C. 313, 38 S.E. 2d 222 (1946).

[24] Fidelity Union Trust Co. v. Warren, 135 N.J. Eq. 239, 38A. 2d 124 (1944); Ericson v. Childs, 124 Conn. 78, 198 Atl. 176 (1938).

[25] *See* Gaede v. Carrol, 114 N.J. Eq. 524, 169 Atl. 172 (1933); 22 CALIF. ST. B. J. 492 (1947).

[26] Wellman v. Cleveland Trust Co., 107 Ohio St. 267, 140 N.E. 104 (1923); Wachovia Bank & Trust Co. v. Lambeth, 213 N.C. 576, 197 S.E. 179 (1938).

[27] See Karch, *The Apportionment of Death Taxes*, 54 HARV. L. REV. 10 (1940); *In re* Harjes Estate, 10 N.Y.S. 2d 627 (Surr. Ct. 1939) (court charged interest against income accumulated since death and balance against corpus).

tion that the burden of the tax shall fall where the law places it.[28] It cannot go so far as one unreconstructed testator attempted in 1904 and provide that no inheritance taxes shall be collectible with respect to his property.[29] It must be tested however, so as to cover all of the following conditions: (1) Coverage of all taxes levied against decedent and his estate and possible interest charges resulting from contesting taxes. (2) Coverage of all transfers, whether intervivos, testamentary or hybrid transfer such as joint ownership of government bonds, estate by the entirety and the like. (3) Specification of property interests to be exempt from the tax burden. (4) Minimization of tax burden by proper allocation thereof.

Review of will provisions to take care of the first two of the above conditions is a matter of planning and draftsmanship which a study of the provisions in the appendix hereto will bring into focus. But the latter two conditions have had little prominence in will drafting. Exemption of property from the tax burden is important because of its non-liquid nature, or because of the financial resources of the beneficiary, or because of fluctuations in the value of property. If will provisions are inexact and fail of their purpose, beneficiaries may have to put up hard cash for that antique bedroom furniture. Again the beneficiary may not have the money to advance the tax on a piece of unimproved real estate in a large estate at a time when banks are not lending money on such property.

But exempting property interests and reducing the tax burden are also important considerations where there is a gift to a charity or educational fund, or under the Revenue Act of 1948 in determining the amount of the marital deduction. Tax minimization can be quite effective in these two fields. But extreme care must be exercised by actual computations of the tax burden or the practical objectives of the testator will be sacrificed for tax reduction.

Under IRC §812 (e) (1) (E) pursuant to the 1948 Revenue Act, the value of the interest qualifying for the marital deduction shall be reduced by the amount of death duties to be paid out of that property. Thus, in the absence of provision in the will, it is reduced by the part of the federal estate tax, the N. C. estate tax and N. C. inheritance tax payable out of the particular property. So in an adjusted gross estate of $500,000 the maximum marital deduction will not be 50% thereof or $250,000 but will be $250,000 less the amount of death duties payable out of that $250,000 worth of property passing to the surviving spouse. Where the property passing to the spouse is not exempt from the tax burden, the calculation of the amount of that tax to be deducted is some-

[28] Plunkett v. Trust Co., 223 Mass. 471, 124 N.E. 265 (1919).
[29] *In re* Morris Estate, 138 N.C. 259, 50 S.E. 682 (1905).

what complicated; but in general, the federal and North Carolina taxes are computed tentatively without reference to the taxes imposed upon the marital interest. Such tentative taxes are then increased to their true amounts by the application of factors determined from an algebraic formula.[30] To show the effect of taxes assume that the residue amounted to $260,000, one half of which was to pass to the spouse, and that taxes were to be paid from total residue. If taxes on the whole estate were $130,000 the net passing to the widow would be computed as follows:

Residue	$260,000
Taxes	130,000
Residue	$130,000
One half	$ 65,000

By a provision in the will relieving the property interests passing to the surviving spouse of all tax burdens, the full marital deduction is available, the tax calculation is simplified and the net taxable estate is reduced by the tax allocable to the spouse's interest. Thus, if there was a devise and bequest to the spouse of one-half of residue computed before deduction of death duties, this would permit a marital deduction of one-half of $260,000 or $130,000 instead of $65,000.

The net taxable estate is reduced by the shifting of the tax burden from her interest and increasing the marital deduction. Naturally the so called "second tax" on these property interests upon the death of the spouse would be imposed upon the larger amount of property in the hands of the spouse. No real saving will be effected by shifting the tax burden from the spouse's interest where the surviving spouse's property interests exceed the federal estate tax exemption and the applicable tax brackets on the two estates are not greatly disproportionate. Also allocation of tax burden has no tax minimization advantage when the interest passing to the spouse at death equals or exceeds 50% of the adjusted gross estate plus all taxes, estate and inheritance, with which her interest is burdened. Thus in an estate of $500,000 all of which is left to the widow and if taxes are $75,000, the full marital deduction of $250,000 is allowed irrespective of where the taxes are allocated because the spouse receives at least $250,000 (50%) without reduction by taxes.

Under IRC §812 (d) as it has been in effect for some years, a deduction from the gross estate is permitted to the extent of any bequest or devise to a charitable or educational organization. But the amount of this deduction under IRC §812 (d) is to be reduced by the amount

[30] See P-H INH. & TRANSFER TAX SERV. REP. BULL. 4 (June 2, 1948). As applied to charitable deduction see Greeley, *Estate Tax Deduction for Charity*, 45 J. ACCOUNTANCY 433, 511 (1938) and 46 J. ACCOUNTANCY 53 (1938).

of estate and inheritance taxes "payable out" of the bequest or devise. In the case of *Harrison v. Northern Trust Co.*,[31] the residuary estate after payment of debts, administration expenses and specific bequests but not the federal estate tax was approximately $463,000. The executor contended and the Illinois Court held that under Illinois law the federal estate tax was a charge against the entire estate and not against the residuary estate and hence the entire residuary estate which was devised to a charity was deductible in computing the federal estate tax. The Treasury Department contended and the Supreme Court of the United States agreed that under state law, the residuary estate that actually was to be distributed to the charity was reduced by the amount of the estate tax and hence only the net residuary estate was deductible. In that case the federal estate taxes were computed at approximately $460,000 and hence the charitable deduction was allowed only to the extent of the net residuary estate of approximately $3,000.

Apparently neither the Illinois law nor the will required that the individual bequests be reduced by the amount of the pro rata part of the tax. If it had imposed all taxes on the specific bequests it is submitted that the burden of the tax would not have fallen on the residuary estate and the charitable deduction would have been allowed to the extent of the residuary estate before taxes. Thus look again at our hypothetical case of a gross estate of $500,000 where specific bequests amounted to $250,000, administration expenses and debts $30,000 and the residue passes to a charity.

Witness the different treatment where the residue to charity is and is not burdened with taxes

	Tax Burden Not on Residue		Tax Burden on Residue
Gross Estate	$500,000	$500,000	$500,000
Less Debts, etc.	30,000	30,000	30,000
Adjusted Gross Estate	$470,000	$470,000	$470,000
Less			
Specific Bequests[32]	250,000		
Residue to Charity	$220,000	220,000	220,000−X
Net Taxable Estate		$250,000	$250,000+X
Approx. Fed. Tax		47,700	$ 47,700+(30%×47,700)
			$ 47,000+14,300
			$ 62,000

The above calculation is a very rough one based on the theory that the additional tax is computed at the highest bracket of the estate. But

[31] 317 U.S. 476 (1943).

[32] Where taxes are assessed against specific bequests, net to beneficiaries is affected but taxes do not affect residue.

approximately $15,000 is the saving on this sized estate. It is also noted that allocation of the tax burden is always important in the case of a charitable deduction irrespective of the amount of the interest passing although it may not be where there is a marital deduction.

It is thus seen how important the factor of reducing bequests by the burden of taxes is. The saving may not appear substantial but in many instances will alone equal or exceed the saving by means of the marital deduction. The effect of such burden operates the same in respect to both the marital deduction and the charitable deduction. Whether the bequest to the spouse or the charity is to be by means of a specific bequest or a residuary bequest is dependent in turn upon how the burden of the tax can be distributed. The greatest marital or charitable deduction can be obtained by expressly freeing such bequest from the tax burden. But as to state inheritance taxes, a bequest to a charity is an exemption rather than a deduction. N. C. GEN. STAT. §105-3 (1943). And there is at present no marital deduction under the state inheritance tax.

In conclusion a study of special provisions should be made so that the provision adaptable to your will is adequate. Anything less than specific and clear language will cause the court to disregard the provision and resort to local law. Thus the tax burden may not only fall upon the members of the family who should be relieved of the burden but the maximum saving in taxes may be thwarted.[33]

In the appendix hereto there are set forth some provisions which point up the questions involved in this discussion.

A review of these provisions illustrates that there can be no stereotyped tax provision applicable to all wills. It should be tested both contextually with other provisions and mathematically under present tax rates to be sure the tax burden is equitably apportioned and affects the greatest tax minimization practical. Drafting of tax provisions is still a comparatively untouched field and the draftsman can make marked improvement on all standard provisions.

The following are some of the pertinent matters to consider in the terminology of these provisions:

(a) Since real estate when passing by even a residuary clause is not ordinarily available for payment of debts until after exhaustion of personalty, does the provision include payment out of personal and real assets, in that order of priority, pro rata, or in the discretion of the executor?

[33] A collection of some will provisions is set out in Notes, 51 A.L.R. 454 (1927), 116 A.L.R. 854 (1938). See also Rippel v. King, 126 N.J. Eq. 297, 8 A.2d 777 (1939). A collection of additional provisions which can serve as a check list is collected in STEPHENSON, TAX PROVISIONS OF WILLS AND TRUST AGREEMENTS (Grad. Sch. of Banking, Lecture Series No. 2 1941).

(b) Does the provision include taxes against beneficiaries of the property constituting the taxable estate as well as beneficiaries of the probate estate and the real estate?

(c) Does the provision charge the tax against specific property interests and adequately define and identify them?

(d) Are the property interests intended to be exempted adequately identified?

(e) Are all taxes sufficiently taken care of?

(f) Does the executor have discretion to compromise and determine the amount of taxes and the apportionment of the burden or shall he compromise at his peril?

APPENDIX

A.

Will Provision for Sale of Assets

ITEM —. My Executor or successor shall have full power, authority and discretion and without order of court to sell for cash at public or private sale and convey by full warranty deed in fee, transfer and deliver, any or all residuary property, whether real or personal. The sale of said property may be made to any person whether or not they may be beneficiaries under this my will or are in any degree related by blood or marriage to me. Whether or not the sale is made to any person related by blood or marriage to me or to any other person standing in a position of confidence or trust, the property or any part thereof may be sold at the value thereof finally determined for Federal Estate Tax purposes, whether or not such valuation is fixed by court order, compromise, agreement or otherwise accepted by the United States Treasury Department; and sale at such value shall be conclusive upon all parties, legatees or devisees having any interest in my estate, whether vested or contingent.

Without limiting the applicability of the foregoing paragraph of Item—, the sale of the ———— Sausage Company, a sole proprietorship, shall extend to the complete business as a unit. Such sale shall include cash, accounts receivable, intangible assets or tangible assets, real estate, plant machinery, railroad siding, office equipment, trucks and all other properties incident to or used in connection with said business. All liabilities shall be assumed and discharged by the purchaser who shall post a bond to hold my executor and my estate harmless against liability for any indebtedness of such business outstanding at time of sale. Until sale of such business, my executor shall have full power, discretion and authority without order of court to continue operation of said business or to lease the same upon such terms as my

executor may, in its absolute discretion, deem best but shall not be required to make any capital additions to such business except as may be required in the ordinary preservation of the property.

B.

Trust Provision for Purchase of Assets

The Trustee is authorized at any time and from time to time and to any extent necessary to assist my executors in the administration of my estate, to make loans with or without security to my estate which loans may extend beyond the period of administration by agreement with testamentary trustees or otherwise, to exchange any part of the trust res for assets held by the estate, and purchase any of the assets of my estate. The Trustee shall have full power, discretion and authority to exercise these powers without order of court and upon such terms as it shall deem best and to charge all disbursements against principal or income and its action shall be binding upon all persons interested in this trust estate.

C.

Will Provision for Continuing a Business

ITEM —. My Executor and Trustee, in either or both capacities, or their respective successors, shall have full power, authority and discretion from time to time and without order of court, to transfer, settle, lease, adjust, sell, dispose of, continue operation of, or otherwise deal with any business interest in my estate whether the same be a sole proprietorship, a partnership, an association, joint venture, corporation or other business. Any continuance of operation of a business in any form shall subject my estate and trust to the same business risks as if I were personally living but neither my Executor nor my Trustee shall be liable or otherwise surcharged for any loss incurred from the exercise of any of the powers authorized by this Item—, of My Last Will and Testament.

Without limiting the foregoing powers my Executor or Trustee may cause or join in causing a corporation or corporations to be formed under the laws of any jurisdiction and to transfer and convey to such corporation or corporations as capital and/or as paid in surplus all or any part of any interest in any busines which may be owned at my death or acquired in connection with the administration of my estate and trust.

The power of disposition with respect to the ———— Motor Company shall be limited so that at least a —— percent interest in the control of the business shall be retained in my estate until the termination of the trusts herein set up whether said interest is represented by voting stock,

by contract or other means. But nothing herein shall require the same or any particular percentage in value of capital interest to be retained in the event my executor or trustee deems a disposition of a portion of such interest to be advantageous to the growth of the business or be otherwise advantageous to my estate.

D.

Will Provisions for Payment of All Death Taxes Out of Residuary Estate

(1) "All estate, inheritance and succession taxes for which my estate or any beneficiary hereunder may be liable as such beneficiary, including taxes on insurance policies and on any other property not passing by this will shall be *paid out of my residuary estate.*"[1]

(2) "I direct that all estate and inheritance taxes and other taxes in the general nature thereof which shall become payable upon or by reason of my death in respect of any property passing by or under the terms of this Will or any codicil thereto hereafter executed by me, or in respect of the proceeds of any policy or policies of insurance on my life or in respect of any other property included in my gross estate for the purposes of such taxes, shall be paid out of the *principal of my residuary estate in the hands of my executor.*"[2]

Death Tax Provision Excluding Taxes on Insurance Payable to Specific Beneficiaries and on Intervivos Transactions:

(3) "FIRST, I direct my executor to pay my just debts, except such as shall be secured at the time of my death by mortgage, if any, and my funeral and testamentary expenses. I further direct said executor to pay all the estate, inheritance, succession, legacy and transfer taxes, whether imposed by the laws of the United States or this state or any other state or country, *upon my estate and upon all legacies given by this will* and to charge such payments against the residue as a testamentary expense."[3]

(4) "All inheritance, succession and estate taxes, both federal and state, which may be assessed against *my estate, or against any legatee or devisee* in this my will named, shall be paid by my Executors, so that each legatee or devisee shall receive his or her legacy or devise in full, clear and free of all taxes herein described."[4]

[1] Morehead, *How to Minimize Estate Taxes in Drafting Wills,* 23 TAXES 1144 (1945).

[2] Probated in N.C., 1946.

[3] Shepherd and Pruyn, *Some Federal Tax Aspects of Will Draftsmanship,* 25 TAXES 433 (1947); would not apply to intervivos transaction; Commercial Trust Co. v. Therber, 136 N.J. Eq. 471, 42 A. 2d 571 (1945).

[4] Priedeman v. Jamison, 356 Mo. 627, 202 S.W. 2d 900 (1947).

Death Tax Provision Including Taxes on All Taxable Interests Without Specifically Calling Attention to Intervivos Transactions:

(5) "FIRST, I direct my executor to pay my just debts, except such as shall be secured at the time of my death by mortgage, if any, and my funeral and testamentary expenses. I further direct said executor to pay all the estate, inheritance, succession, legacy and transfer taxes imposed by and made payable under the laws of the United States or this State or any other State or country *by reason of my death,* and to charge such payments against the residue as a testamentary expense."[5]

Additional Provisions for Payment of Death Taxes

(6) My Executor shall pay out of my residuary estate all "transfer, inheritance and estate taxes to which my property may be liable."[6]

(7) "I direct that all my debts, costs of administration and inheritance and estate taxes, whether on property passing under this Will or otherwise, shall be paid by my executor's hereinafter named out of the *general funds* of my estate as early as possible after my death and in keeping with good business and the terms and provisions of this my Last Will and Testament."[7]

(8) I direct that all estate, inheritance, succession, transfer and other taxes, by whatever name called levied against my estate as a whole, or against any legacy or devise, or against any legatee or devisee, whether levied by the Federal Government or by any State Government or political subdivision of any state, shall be paid by my executors out of my general estate, it being my intention that my legatees and devisees shall receive the full amount of the legacies and devises hereinafter made without any diminution on account of such taxes.[8]

(9) My Executor shall pay out of my real or personal estate which remains after discharge of specific legacies and devises mentioned in Items ——, all funeral expenses, all my just debts, the costs and charges of the administration of my estate, and all income, transfer, gift, stamp, advalorem, estate, inheritance, succession, or other taxes together with interest that may be due with respect to any of such taxes that are determined to be due to the Federal Government, any Foreign Government, the Government of any State or any political subdivision of any governmental unit whether such taxes were incurred by me during my lifetime, by my said estate during its administration, or *are imposed*

[5] Shepherd and Pruyn, *supra* note 3; Central Trust Co. v. Lamb, 74 Ohio 299, 58 N.E. 2d 785 (1944) (similarly worded provision was thus construed).

[6] United States Trust Co. v. Sears, 29 F. Supp. 643 (D. Conn. 1939) (such a provision does not shift the burden of the tax on insurance).

[7] Probated in N.C., 1945. The term "general estate" has been held to mean residuary realty and personalty. Nashville Trust Co. v. Grimes, 179 Tenn. 567, 167 S.W. 2d 994 (1943).

[8] Probated in N.C., 1937.

with respect to property included in the taxable estate by reason of my death whether subject to administration by my executor or not.

My Executor shall have complete discretion in determining the amount of all taxes, debts, costs, and charges due, and the apportionment of the burden thereof, as between real and personal property and any such determination or valuation of property interests involved therein shall be conclusive and binding upon all legatees, devisees or others interested in my estate.

E.

Will Provisions for Apportioning the Tax Burden

(1) "Said Executors shall pay the Federal Estate Taxes against my estate out of the principal of the assets of my estate; but each legatee or devisee must pay the North Carolina Inheritance Tax against the legacy or devise to him, to her or to it."[9]

(2) My Executor shall pay out of my real or personal estate which remains after discharge of specific legacies and devises mentioned in Items ——, all funeral expenses, the costs and charges of the administration of my estate and all my just debts including income, gift, stamp, and advalorem taxes together with interest that may be due with respect to any of such taxes that are determined to be due to the Federal Government, any Foreign Government, the Government of any State, or any political subdivision of any governmental unit, whether such taxes were incurred by me during my lifetime or by my said estate during its administration.

All estate, inheritance and succession taxes together with interest due with respect to any such tax which may be imposed with respect to property included in the taxable estate by any such governmental unit by reason of my death and whether or not subject to administration by my executor shall be paid out of and apportioned against property interests, whether real, personal or mixed except such interests as may qualify under the marital deduction for Federal Estate Tax purposes. Inheritance and Succession taxes shall be charged to the property interests upon which imposed and Estate taxes shall be pro rated over all property interests included in the computation of such tax in proportion that the tax value of each property interest bears to the total tax value of all such interests without regard to exemptions, deductions and credits; provided that such taxes allocable to non-terminable interests passing to my wife and all such taxes uncollectible by my Executor shall be reallocated in equitable proportion to and payable out of all

[9] Probated in N.C., 1946.

other property interests so that such property interests passing to my wife shall pass free and clear of all such death taxes.

The amount of any tax or any part thereof shall be and continue a charge against the particular property interest and be collectible by the executor from said property by sale thereof; provided that corpus of property interests shall bear the burden of all taxes on various interests created therein.

My Executor shall have complete discretion in determining the amount of all taxes due, the apportionment of the burden thereof, the feasibility of collecting the tax from a particular property interest and any such determination or any valuation of property interests involved therein shall be conclusive and binding upon all legatees, devisees or others interested in the property comprising the taxable estate.

(3) All estate, inheritance, succession and transfer taxes shall be equitably prorated among the beneficial interests comprising my taxable estate in such a manner and as my executor in its sole discretion shall deem fair and practicable provided that the portion of any such tax imposed with respect to property held by me and my wife as tenants by the entirety or a joint tenancy shall be paid out of real and personal estate constituting residium after my debts and specific legacies are discharged.

F.

Intervivos Trust Provision for Taxes

(1) Upon request by the Executor of the Settlor, the Trustee is directed to pay and discharge any and all estate, inheritance, succession or transfer tax which may be imposed upon or with respect to this trust or upon the interests of any of the beneficiaries of this trust by reason of the death of the Settlor. The Trustee is further authorized and directed to pay any and all income taxes imposed upon the income of the trust. Any income taxes payable by any beneficiary of this trust may be paid by the Trustee, in its discretion, whether or not the same is entirely or partly due to income from this trust.

Any and all taxes paid by the Trustee pursuant to this Article shall be charged against principal or income, or the share of any beneficiary in principal or income, or otherwise apportioned as the Trustee, in its discretion, shall deem fair and equitable and the determination of the Trustee as to the proper apportionment of the tax burden shall be binding and conclusive on all persons interested in this trust.

(2) The Trustee is authorized and empowered in its discretion to pay and discharge any and all estate, inheritance, succession or transfer

tax imposed upon or with respect to all property included in the taxable estate of the Settlor by reason of his death, whether or not such property is subject to administration by my Executors but including taxes imposed with respect to the property interests comprising this revocable trust. The Trustee is authorized and directed to charge the corpus of this trust with all such taxes together with any and all interest paid with respect thereto.