Woman C.P.A.

Volume 18 | Issue 3 Article 4

4-1956

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Recommended Citation
Lasseter, Ethleen (1956) "Accountant and Estate Planning," *Woman C.P.A.*: Vol. 18 : Iss. 3 , Article 4.
Available at: https://egrove.olemiss.edu/wcpa/vol18/iss3/4

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THE ACCOUNTANT AND ESTATE PLANNING

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Any discussion of the accountant and estate planning must of necessity begin with a general discussion of estate planning.

What is estate planning? All too frequently estate planning is considered to consist simply of making a will. Certainly, the will is the cornerstone, and the importance of properly drawn wills cannot be over-emphasized. Wills, however, important as they are, are but one of the several elements involved in a complete estate planning job.

Often estate planning is looked upon as a scheme for tax savings, or—perish the thought—tax evasion. The incredibly complex tax laws of today, and the involved forms of property ownership and transfer, that have been the natural result of those laws, have focussed a wider and more intense attention upon the importance of estate planning. Also, the fact that taxes, both income and estate taxes, can be minimized legitimately through a sound plan should not be overlooked. Nevertheless, any estate plan would be dangerous indeed if tax savings ideas were the sole basis for the plan for the devolution of property. Tax savings, like the will, is but another of the elements of an effective estate plan. Of paramount importance over all others is the human element.

The two basic objectives of an estate plan—and they are of equal importance—should be:

1) "To effect a plan of ownership and control of property, within the family group, that will produce a maximum of enjoyment, security and benefit for the owner during his lifetime.
2) "To make such plan for the devolution of property upon the death of the owner that will produce the maximum of enjoyment, security and benefit for his beneficiaries after his death."*

To accomplish those objectives, the overall estate plan must be designed to minimize the destructive forces that constantly attack estates and invade the rights and benefits of the owner or beneficiaries. In addition to taxes those forces include economic trends, bad management, human weaknesses, and inflexibility of the documents under which administration must be carried out.

In designing such a plan, there are three cardinal principles that must be kept foremost in mind.

1) Liquidity must be sacrificed only to the extent clearly determined by necessity. Often a person's earnestly developed plan is wrecked completely because he failed to provide sufficient liquid assets to cover debts, taxes, and expenses.
2) Plans must be flexible enough that the fiduciary will be able to reasonably meet the unexpected. A will drawn when the family fortunes are at the height of prosperity and happiness may be probated at a time when fate has completely reversed the wheels of fortune.
3) Capacity to work and earn may be far more important than invested wealth. Salaries or earned incomes of $10,000 are not uncommon today but it would take an estate of at least $200,000 to produce income of equal amount.

The Testator and His Family

The basic fundamental of an estate planning job is a thorough knowledge and understanding of the nature and characteristics of not only the estate owner but also of each member of his immediate family. What is his age and condition of health? His wife's age and condition of health? What is her general attitude toward the children, especially if there are children by a former marriage, and toward her husband's personal and business activities? Is she, or the children, extravagant or conservative? Does she, or the children, have, or are they likely to inherit, independent estates? What are the ages and marital status of the children? Are there any adopted children? (Reference to children in wills as "issue" or "descendants" could exclude adopted or step children). Are there any deceased children who left children surviving? Will any of the children, because of physical or other

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* *Trusts and Estates*, 1950.

handicaps, require special provisions or different handling, for his or her share? Are there any other dependants to be provided for—parents, aunts or uncles, nieces or nephews? Are there any abnormal situations that must be dealt with?

What are the estate owner's wishes in regard to plans for provisions for his family after his demise? Does he wish his wife or sons or sons-in-law to assume control and management of his business? Is it his desire that any of the children have special education and training for a profession, or that they be encouraged to establish their own business? Does he have an interest in any pet civic or charitable projects that he wishes continued? What is the nature and extent of his personal liabilities, both actual and contingent? Does he wish his wife to be spared from all the responsibilities and risks of property management, or is she really capable and willing to carry on? What else does he hope to accomplish during his lifetime, then through his estate?

With all the pertinent information concerning the individuals involved in hand, the attention of the estate planner turns to the property of the estate owner, the property that must be marshalled and employed to accomplish his aims. How can the ownership and control of that property be arranged to produce the maximum in enjoyment, security and benefit during the remainder of the lifetime of the owner, or creator, of the estate; also, thereafter? Which of the many tools of estate planning can be employed most effectively?

Estate Planning Tools

Estate planning tools available to the estate planner are innumerable. A few are simple, but most are terribly complex and require the technical knowledge and skill of professionals in selection and application. Often professionals from several fields are required. In the matter of selection of estate planning tools, the security of the owner while he lives, and the welfare of his family following his death, should be given primary consideration. When the best plan in that respect has been determined, then considerations should be given to putting it into effect with the greatest tax savings that is practical. Tax savings schemes that border on tax evasion should be avoided as they are sure to lead to trouble sooner or later —usually when it is too late for corrective measures. The skilled tax practitioner, however, often can suggest an almost infinitesimal change in a plan or instrument that will not disturb dispositive plans but will save an untold sum in taxes over a long period of years for the benefit of perhaps two generations or more. Space does not permit a comprehensive discussion of the estate tax devices available, only brief mention of those most widely used.

Trusts

First and foremost, there are trusts. From the standpoint of accomplishing the ultimate aim of the owner in providing for his family and philanthropies, or of controlling the impact of taxes and economic forces that constantly attack estates, trusts have unlimited possibilities. Mostly, however, trusts are very complex and unless properly planned and executed they can be equally disastrous.

Unfortunately there are some persons who still associate trusts with spendthrifts and incompetents. Also, there are many who feel that gifts in trusts, or estates in trust, indicate that the Donor or Testator lacks confidence in the stability and judgment of the donee or beneficiary. Instead of being looked upon as a reflection in any respect trusts should be looked upon with great pride. They are a means of providing combined matchless experience and continuity, granting of course that an experienced corporate fiduciary is appointed, in property management, investments, tax matters and estate administration. Certainly, no one individual could possess all the qualifications required to administer a complex estate.

Frequently, the larger income a man and his family enjoys is dependent almost wholly upon a franchise. As companies granting franchises prefer personal ownership management it is extremely difficult at times to retain the earning power of franchises for beneficiaries of the owners estate. Nevertheless, many families continue to enjoy substantial income because the owner left his business in trust, naming an experienced and influential corporate trustee who through skillful negotiation was able to retain the franchise for the trust estate.

Revocable Trusts

When the numerous advantages of revocable trusts are considered, it is surprising indeed, and not to the credit of estate planners I fear, that they are not more widely used. It indicates that tax saving too often is the motivating factor in establishing trusts.

Properly planned, the revocable trust can obviate the necessity of probate in small, or comparatively simple, estates. In addition to eliminating, or greatly reducing, administrative costs, they provide a greater degree of privacy in states where inventories, appraisals and accountings must be filed with the Court to become public records. The principal of the trust is not subject to the perils of testamentary property. Seldom are revocable trusts upset by unsound mind and undue influence factors. Nor, is the principal subject to the creditors of the grantor or his estate (if he were solvent when the trust was created).

If the grantor's estate is of sufficient proportions for estate tax to be involved, a secondary or succession federal tax in the beneficiary's estate may be avoided by providing a succession in beneficiaries, within the limits of the law of perpetuities, of course.

No one likes to think, much less talk about becoming incompetent, but it happens every day, among the wealthy as well as among the less fortunate. For all those legally declared incompetent, there is an even larger number who would be except that their families would feel embarrassed over the publicity that attends guardianshop. Of course the greatest disadvantage to guardianship, and one the family seldom realizes, is the unnecessary court costs and bond. The revocable trust serves no greater human need, especially for elderly people, than as a means of insuring continued maintenance, support, and medical care of donors, when such circumstances arise, without the costly and unsatisfactory processes of guardianship. To accomplish such purposes, it is necessary that the trust instrument give the trustee full authority to make purchases and sales, and to disburse income and/or principal for the benefit of the donor, or beneficiary if the trust should be created by someone else. Similar arrangements are equally desirable in trusts, whether intervivos or testamentary, where there is any possibility of minors being involved and it is not at all unlikely, when income is bequeathed to adult children, that it will be minor grandchildren who actually will receive it.

And of course, we should not overlook the fact that the revocable trust is just what its name implies—revocable. There can be disastrous results indeed to irrevocably relinquishing all rights to an interest in life estates or in the property itself if it might subsequently be needed for the support and welfare of the donor.

The Marital Bequest

The marital deduction bequest, under which estate tax on up to one-half of the adjusted gross estate may be deferred until the death of the surviving spouse, is the newest estate planning tool. Like all tax savings devices, however, unless used with caution it can result in increased taxes. Consequently, careful consideration must be given its many aspects and its possible effect on the combined estates of both spouses.

If the surviving spouse has a relatively substantial estate of his or her own, the marital deduction pyramids property that will be taxable to the estate of the surviving spouse. As a result property escaping estate tax in the first estate will be taxed at a higher rate in the second estate. Even so, however, it still may be found to be advantageous when consideration is given to the income that could be earned during the remaining lifetime of the surviving spouse on the amount saved in estate taxes upon the death of the first spouse to die.

On the other hand, if the surviving spouse has little or no estate, or if it is likely that a substantial portion of the property passing tax free upon the death of the first spouse will be consumed for support during the remaining lifetime of the surviving spouse, considerable estate taxes will be saved, not merely deferred. In such instances, however, it is important that wills specifically provide that marital deduction property be consumed entirely before other property or funds become available for support of the surviving spouse.

It is important also that a sufficient proportion of the property be of a qualifying nature and that the will provide that only qualifying property be used in satisfying the marital bequest.

Contrary to the belief of all too many estate owners, it is not necessary that the marital deduction property be bequeathed in fee simple in order to obtain maximum tax savings. By providing a marital trust and residue trust, all property may be given the protective shelter afforded by trusts. Upon the death of the surviving spouse, however, any unconsumed portion of marital trust property is subject to disposal under the will of the second spouse. That may be to a second husband or wife, or a second set of children. In such instances the first spouse might consider increased estate taxes are preferable

to giving up control over the ultimate disposition of his property.

Probable life expectancy of each spouse, as well as the size of the estate of each, is of especial importance in determination of the extent, if any, the marital bequest is to be used in estate planning. It also necessitates frequent reconsideration of the question as time passes and family fortunes change.

Gifts

Gifts, or transfers during lifetime, properly planned and executed, are often the most effective means of accomplishing not only the client's wishes but also the utmost in overall tax economy. All too frequently, however, proper consideration is not given to the many factors involved and the tax consequences are not realized until the impact of a substantial tax assessment hits the transferor, or his estate. Often property or income is transferred without the transferor realizing that he has incurred a liability. The tax may even be the liability of someone other than the donor or donee.

Whenever gifts are employed as an estate planning tool, the possibilities of tax consequences should be explored thoroughly, and that involves three kinds of taxes: income tax, gift tax, and estate tax. Often substantial savings in one kind of tax will result in increased overall taxes. In determining subsequent capital gains, the donor's cost basis remains the basis of the property in the hands of the donee, although gift tax, and perhaps estate tax also, may have been imposed on the property at a much higher value, thereby often making it inadvisable for the donee to reduce the property to needed cash. However, under the 1954 code, property still in the hands of the donee at the time of the donor's death takes a new basis—the Estate Tax value in the donor's estate.

Consideration should be given to whether the property has appreciated or depreciated in value; also, to who could better use a capital loss, the donor or donee. In many instances, unfortunate tax consequences can be avoided by selling the property and making a gift of the proceeds.

Even though gift tax was paid on the transfer of property during lifetime, the property may later be taxed as part of the estate of the Donor on the contention that the gift was made in contemplation of death. The Revenue Act of 1950, however, mitigated to a considerable extent that danger with the provision that if the donor lives three years after the date of the transfer, the gift will not be presumed to have been made in contemplation of death. The uncertainty of life, however, warrants that some evidence that the motive for the gift was connected with life and not death should be preserved.

Even though property transferred is subsequenty subjected to estate tax, it is quite possible, nevertheless, to effect a worthwhile tax savings, in some instances, through transfers during life since estate tax must be paid on property which is liquidated for payment of the estate taxes while gift tax is assessed only on the property transferred. Also, it should be remembered that under the marital deduction provisions, gifts made to a third person, under certain conditions and upon consent signed by both spouses, may be considered as being made one-half by one spouse and one-half by the other, affording double use of the $3,000 exclusion and $30,000 exemption.

While the marital deduction has greatly minimized the tax savings effect of interspousal transfers during life, they too are still worth considering as they are at least a hedge against loss of the marital deduction by the prior death of the spouse possessing the smaller, or no estate.

While the possibilities of gifts, whether made in trust or outright, are unlimited, the complexities involved warrant that the utmost in consideration be given every aspect of the gift.

The Accountant

An adequate estate planning job usually requires the combined knowledge, skill, and efforts of the so-called four man team —the lawyer, the life underwriter, the accountant, and the trust man. Strange to relate, it is only in recent years that the accountant has become generally recognized as a member of that team. Even now he is not given the recognition that his profession merits, or that estate planning needs. The majority of articles, speeches and advertising material stressing the importance of cooperation in effective estate planning, fails to mention the accountant as a member of the team. Why? Could it be that those who developed the idea of cooperative estate planning have failed to recognize that often the services of the accountant are indispensible to a thorough job. Or, is it that accountants have overlooked a brilliant opportunity to render valuable services to their clients, above and beyond the call of normal duty?

Unless the estate is comprised solely of insurance and listed securities, an accountant will be needed for the exact calculations required to determine the value of closely held stocks and business interests, the most advantageous form of capital structure, or the cost basis of property to be transferred by gift; to arrange for the redemption of stock as now provided for the payment of estate taxes; to prepare estate and fiduciary tax returns; to furnish the owner and executor with comprehensive statements that present an unbiased picture of the condition of businesses and the story of operations reflecting the effectiveness of management.

That the very essence of estate planning is team-work is generally accepted. However, the question often arises as to who should initiate an estate planning job, or who should captain the team, and call the plays. It would seem that the job should be initiated by the member who, whether by chance or not, has the first opportunity, or the one who first gains the complete confidence of the estate owner, and is able to prompt him to action.

Here again the accountant is extremely important. Often it will be the accountant preparing the estate owner's tax return, or auditing the books of his business, who first realizes the owner's estate involves such complex problems that only through careful and immediate planning may the maximum of enjoyment, security and benefit be obtained during the life of the owner, much less after his death. Initiating an estate plan affords the accountant an excellent opportunity of making his influence felt as a useful member of the estate planning team. There are a surprising number of substantial and highly profitable businesses that are strictly one-man affairs. In event of the untimely death of the owner, his estate, if comprised solely of that business which is often the case, could evaporate almost over night. It is the accountant, usually, who first realizes that such condition exists, and who, because of his knowledge of the personnel and the confidence the owner has in his judgment, is in position to direct atttention to some employee who could, and should be developed into a key-man.

The question of WHO shall initiate an estate planning job is not nearly as important as that other members of the estate planning team whose services the particular estate might need, will be consulted at the appropriate point; also, that the professional consultant be one skilled in estate matters, or that he say so. A physician engaged in general practice would not attempt brain surgery. Drafting wills and trust instruments requires the same degree of specialized skill in the field of law that brain surgery requires in medicine.

In view of his experience in administering estates, which usually is where the pitfalls first came to light, the corporate fiduciary has unsurpassed qualifications for serving as coordinator of the estate plan. Certainly, the plan should be submitted to him for review before the legal documents involved are executed. After all he is the one who will carry the ball after the death of the owner.

The technical knowledge, skill, and experience of the professionals will come to naught unless applied with a completely open and unbiased mind. The pitfalls that came to light during administration often indicate that the original plan was guided by the pet prejudices or personal motives of some member of the team, rather than by a wholehearted interest in the welfare of the owner and beneficiaries of the estate. Life underwriters sometimes oversell option settlements when life insurance trusts, because of flexibility, would be more advantageous to the beneficiaries; or, in order to sell a large policy, develop some fantastic tax saving scheme which boomerangs the minute the insured dies. The attorney who won't provide a trust in drafting a will is not unheard of. In one estate recently, it seemed that the only possible way to raise cash for debts, taxes, and expenses without entirely wrecking the estate would be to borrow money. The will, however, did not contain any provisions authorizing the executor to borrow. It later developed that the attorney who drew the will did not believe in executors borrowing money! Neither did he provide any magic formula for getting blood out of a turnip. Of course the attorney, like the testator who was in his early 50's, did not expect the will to be probated for many years, by which time the estate would likely be in a satisfactorily liquid position. Unfortunately, however, the will was probated in less than a year after it was executed. That illustrates the reason for one of the cardinal principles in will drafting—a will should always be drawn as if the testator expected it to be probated the next day.

Estate planners have a responsibility, not only to estate owners and their beneficiaries, but also to society in general to conserve and preserve the wealth represented by personal estates.