WHOSE WEALTH IS IT ANYWAY? IMPEDIMENTS TO THE REALIZATION OF AN OWNER'S PLAN OF DISPOSITION*

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Bentham analyzed property as being "nothing but a basis of expectation; the expectation of deriving certain avantages from a thing."[1] He further observed that:

> As regards property, security consists in receiving no check, no shock, no derangement to the expectation founded on the laws, of enjoying such and such a portion of good. The legislator owes the greatest respect to this expectation which he has himself produced. When he does not contradict it, he does what is essential to the happiness of society; when he disturbs it, he always produces a proportionate sum of evil.[2]

As the title of this essay indicates, the author has concerns about whether a property owner's expectations are being dashed by our legal system, resulting in a "proportionate sum of evil."

The focus of this essay is the extent to which a property owner's intentions with respect to the gratuitous disposition of his wealth are being frustrated by legislation, case law and the art of estate planning as it is currently practiced and administered by the legal profession. This essay first will explore the issue of whether a property owner's dispositive scheme is being effectuated, or, to the contrary, whether it is the estate planner's, fiduciary's or beneficiary's intent as to the owner's wealth that is being implemented. The legal system imposes a variety of restrictions on the attainment of a property owner's dispositive goals. This essay will explore the rationality and equity of these strictures on one's estate planning "expectation." As these impediments to effecting the property owner's in-

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1. J. BENTHAM, THEORY OF LEGISLATION 111 (Hildreth ed. 1931).
2. *Id.* at 113.

tent are explored, alternatives which would allow the property owner more control over his wealth will be suggested.

DO CLIENTS GIVE AN "INFORMED CONSENT" TO THEIR ESTATE PLANS?

The law is attempting to transform the physician-patient relationship from an authoritarian model to one in which the patient plays an important role in the decision making process. The law is doing so, in the medical malpractice area, by its fashioning of the doctrine of "informed consent." This concept mandates that the physician furnish a reasonable disclosure of the risks of proposed surgery or treatment to the patient so that the patient may make an informed choice as to whether he should consent to the medical procedure.[3]

Does the lawyer's client, in gratuitously disposing of his wealth, make a truly informed choice? When executing documents, does the client understand the meaning of terms such as "issue," or the effect of other jargon designed to achieve tax benefits, such as a clause that interrelates the size of the marital deduction and the estate tax credit? On an even broader plane, does the client comprehend the scheme of disposition evidenced in the written documentation of his estate plan?

Needless to say, the lawyer has an ethical obligation to afford his client the opportunity to make an informed judgment on his estate plan. The Code of Professional Responsibility mandates that under normal circumstances the authority to make decisions is exclusively that of the client,[4] and that a lawyer should exert his best efforts to insure that the client's decisions are made only after being informed of relevant considerations.[5] Aside from this ethical imperative, there traditionally has been a relative reluctance on the part of the judiciary to create remedies which encourage informed decision making by estate planning clients. Traditionally, courts have held that a client's misconception of the legal effect of a document is not grounds for its rejection.[6] One court has offered an ominous rationale for this judicial reluctance to grant relief—the fear that a more liberal grant of relief could lead the courts to "upset half the wills in the country."[7] If the courts are reluctant to grant relief on the grounds of mistake, then *a fortiori*, they will be inclined not to intervene in the situation where there is no evidence of mistake but merely proof that the consequences were not adequately explained to the client. Similarly, the attorney who fails to obtain informed consent from a client traditionally has not been

3. W. PROSSER, HANDBOOK OF THE LAW OF TORTS, § 32, at p. 165 (4th ed. 1971).
4. MODEL CODE OF PROFESSIONAL RESPONSIBILITY, EC 7-7 (1981).
5. *Id.* at EC 7-8.
6. T. ATKINSON, WILLS § 58 (2nd ed. 1953). Courts do reform non-probate transfers on the grounds of mistake. In non-probate transfers, parol evidence is admitted to correct mistakes, both of expression and of omission, but courts may test its admissibility against a higher than ordinary standard of proof. *See* Langbein & Waggoner, *Reformation of Wills on the Ground of Mistake*, 130 U. Pa. L. Rev. 521, 524 (1982). As to the enforceability of a will provision controlling the admissibility of parol evidence, *see* Whitman, *Advocating the Use of a Will Provision to Control the Introduction of Parol Evidence*, 5 Prob. L.J. 155 (1983).
7. *In re* Cotter's Estate, 180 Misc. 399, 406, 40 N.Y.S.2d 93, 98 (Surr. Ct. 1943) (*quoting* Matter of Webb's Estate, 122 Misc. 129, 136, 202 N.Y.S. 346, 352 (Surr. Ct. 1923).

subject to personal liability to the client, the client's estate or disappointed beneficiaries, as has been the medical practitioner under analogous circumstances.[8]

If the rationale that the application of a doctrine of informed consent in the estate planning area would "upset half the wills in the country" is valid, serious societal concerns are raised. Although some authorities justify judicial reluctance to intrude into this area on the grounds that evidence of a client's mistake may not be reliable and trustworthy,[9] this justification overlooks the broader issue that the client's intent may well be frustrated and thwarted. We need more solid and substantial empirical data as to whether a client truly understands the scheme of disposition drafted by his attorney and whether the client has made an informed choice with respect to the transfer of his property.

DISCLAIMERS—ESTATE PLANNING BY BENEFICIARIES

Under the Internal Revenue Code, a "qualified disclaimer"[10] by a beneficiary of an interest in property is treated, for tax purposes, as if the interest had never been transferred to the person. In several ways, disclaimers play an important role in post-transfer estate planning. They can rectify prior errors in planning an estate and improve the tax positions of an estate, its beneficiaries and others. By permitting beneficiaires to adjust the size and content of particular gifts, the distribution of property can be made to conform to the realities faced by those beneficiaries. In some circumstances, property in excess of the needs of one beneficiary can be disclaimed so as to benefit another beneficiary. Gifts of property inappropriate or inconvenient in form can be avoided, and gifts that are too large or too small to achieve maximum tax advantages can be modified. In short, disclaimers make useful adjustment to an estate plan possible based on the facts and circumstances actually faced by the transferor's beneficiaries.

Disclaimers Triggered by the Marital Deduction

One of the most important circumstances in which disclaimers may prove useful is in connection with the marital deduction. For example, sometimes it is determined that a surviving spouse, who has been given less than the maximum marital deduction, should receive more property in order to increase the size of the marital deduction. In this situation, the deduction may be augmented by another beneficiary's timely disclaimer in favor of the surviving spouse.[11]

8. *Cf.* Lucas v. Hamm, 56 Cal. 2d 583, 364 P.2d 685, 15 Cal. Rptr. 821 (1961).
9. ATKINSON, *supra* note 6, at § 58.
10. I.R.C. § 2518(a) (1983).
11. See I.R.C. § 2518 (1983); Treas. Reg. § 20.2056(d)-1(b), T.D. 6296, 23 F.R. 4529 (1958); proposed amendment § 20.2056(d)-1(a), 3 Fed. Est. & Gift Tax Rptr. (CCH) ¶ 11,920, at 15,351 (1980). Section 2518 encompasses a more specific provision, § 2056(d)(2), which was repealed in 1976; the rule, however, did not change. *See* H.R. Rep. No. 94-1380, 94th Cong., 2d Sess. 67 (1976) (the qualified disclaimer "is to be taken into account for purposes of the estate tax . . . marital deduction as under present law").

Conversely, in several situations,a surviving spouse may wish to disclaim part or all of the marital deduction property received. The first situation is where the surviving spouse's own assets are so substantial that the total taxes on both estates may be larger than if the marital deduction had been used to a lesser extent in the estate of the first decedent.[12] This situation may occur because of the augmentation of the survivor's estate by the marital deduction gift. A disclaimer that subjects the property to taxation in the deceased spouse's estate may be preferable to deferring a tax on the marital deduction portion until the surviving spouse's death.

A disclaimer may also be appropriate where a larger or maximum marital deduction is unnecessary to eliminate the obligation to pay estate taxes on the first decedent's death. The unified credit[13] might eliminate any tax liability on the first decedent's estate without the maximum or larger marital deduction; therefore, taking the larger or maximum marital deduction would unnecessarily augment the size of the survivor's estate.

Another circumstance in which a disclaimer may be advisable is when a transfer to a surviving spouse does not qualify for the marital deduction because it is formally defective. For example, assume that a marital deduction trust is created; under its terms, the surviving spouse is to receive income for life and has a general testamentary power to appoint the remainder as she may see fit, but the trustee has the power to retain unproductive property for an unreasonable period of time. Under the current Treasury Regulations, the trust will not qualify for a marital deduction because the retention of such property by the trustee may preserve the property at the expense of the spouse's beneficial enjoyment of the property and its income.[14] The trust, therefore, will be subject to estate taxation in the deceased spouse's estate. In addition, the property also may be subject to estate taxation in the surviving spouse's estate unless the latter disclaims the general power of appointment. A disclaimer of that power of appointment would convert the defective gift into nonmarital property transferred to the trustee. This property, although taxable in the decedent's estate, will bypass the estate of the surviving spouse, who upon death will have no interest in the property since the life interest and power given her would have terminated. Thus, double taxation of the property is avoided.

Disclaimers Used as a Flexibility Device and as an Aid in Planning for Charitable Deductions, Generation-Skipping Tax Liability and Powers of Appointment

In addition to its use as a device to achieve estate tax savings with regard to the marital deduction, a disclaimer may be used to adjust the division of a residual estate to reflect economic circumstances not foreseen in planning the estate. For example, suppose that at the time he drafted a

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12. *See* W. SCHWARTZ, FUTURE INTERESTS AND ESTATE PLANNING § 14.14 (1982 Supp.).
13. I.R.C. § 2010 (1983) provides for a credit against the estate tax liability of a decedent's estate.
14. Treas. Reg. § 20.2056(b)-5(f) (4)-(5) (1958).

will, T had no spouse but had three children, all with similar financial needs. T therefore divided his residual estate evenly among the three. At T's death, however, one of the children, A, has become wealthy in his own right, whereas another, C, has contracted a debilitating chronic disease. Even though the estate is to be divided evenly, A can effectively increase C's share without incurring gift tax liability by disclaiming his share, thus giving B and C half shares in the residue of the estate. Had A not disclaimed and later given C additional gifts to meet his needs, A might have had to pay taxes on the gifts. Thus, any time a bequest becomes unnecessary or excessive, a disclaimer may be used, and if the instrument creating the interests so permits, the disclaimed property may pass to someone with greater need of it.

The estate tax charitable deduction may also be affected by a disclaimer. A proper disclaimer of property by a noncharitable beneficiary in favor of a qualified charity results in the disclaimed property qualifying for the charitable deduction.[15] A disclaimer can be especially helpful when a gift of a remainder interest to charity is involved. In order to qualify for the estate tax charitable deduction, a trust must satisfy the detailed and technical requirements of a charitable remainder trust.[16] If the trust fails to meet these requirements, a charitable deduction could be preserved if the noncharitable beneficiaries totally disclaim their interest and thus cause the charity to receive the property outright.

Problems that arise from the tax on "generation-skipping" transfers imposed by the Tax Reform Act of 1976 also may be remedied by the timely use of a disclaimer. If, for example, a trust is created which provides that income is payable to the grantor's surviving spouse for life, then to the grantor's child for life, and then to the grantor's grandchildren, the trust would be a generation-skipping trust because beneficiaries of the trust are assigned to two or more generation levels younger than the grantor's generation.[17] Accordingly, a generation-skipping transfer tax might be imposed at the death of the grantor's child. The tax could be avoided, however, if the grantor's child disclaims his interest. The disclaimer would prevent the trust from constituting a generation-skipping trust because there would no longer be two or more generations of beneficiaries whose generation levels are "younger" than that of the grantor. The grantor's widow is assigned to the same generation as the grantor, and hence there would be only one level of younger generation beneficiaries, the grandchildren.[18] Thus, where one of the beneficiaries of a generation-skipping trust has no need of his income interest, the imposition of the tax on an other-

15. See I.R.C. § 2518 (1983); Treas. Reg. § 20.2055-2(c)(1); proposed amendment § 2055-2(c)(1), 3 FED. EST. & GIFT TAX RPTR. (CCH) ¶ 11,920, at 15,351 (1980). Section 2518 encompasses the substance of a more specific provision, § 2055(a), which was repealed in 1976; the rule, however, did not change. *See* H.R. Rep. No. 94-1380, 94th Cong., 2d Sess. 67 (1976) (the qualified disclaimer "is to be taken into account for purposes of the estate tax . . . charitable deduction as under present law").

16. Treas. Reg. § 1.664-1, T.D. 7202, 37 F.R. 28288 (1972).

17. *See* I.R.C. § 2611(b) (1976).

18. *See* I.R.C. § 2611(c)(2) (1976).

wise taxable termination may be avoided by a timely disclaimer of the unnecessary interest.

Finally, the disclaimer may be helpful if a person holds a general power of appointment with respect to property. If the person dies holding the power, the property subject to the power is includable in his gross estate for federal estate tax purposes.[19] This result can be avoided by the donee disclaiming the power during his lifetime, since section 2518 of the Internal Revenue Code includes "powers" as disclaimable property interests.[20]

Disclaimers Used to Avoid Income Taxes

In addition to being helpful post-transfer estate tax planning tools, disclaimers are a useful way for living taxpayers to avoid present income tax liability. For example, a disclaimant may not be required to include future income attributable to the disclaimed property in his taxable income.[21] In addition, a person other than the grantor of a trust is treated for income tax purposes as the owner of a portion of a trust if, with respect to such portion, that person has an exclusive power to vest the corpus or the income of the trust in himself.[22] If the power referred to has been disclaimed within a reasonable time after the holder of the power first became aware of its existence, such a person is not treated as the owner of the portion of the trust.[23] Thus, timely disclaimer of income-producing property or of certain trust powers can prevent unnecessary income taxation.

The Effect of a Disclaimer on the Transferor's Intent

The disclaimer, then, when properly used, not only offers the estate planner a tool for post-transfer correction of planning errors or miscalculations, but also facilitates a fine tuning of an estate plan to compensate for and adjust to changes in the financial conditions and circumstances of the beneficiaries that were not foreseeable at the time the estate plan was formulated. Despite these advantages, the disclaimer must be recognized as posing a threat to the effectuation of the transferor's intent. Although state statutes commonly designate the alternative recipient of the disclaimed property,[24] the statutory selection of the alternate taker may not be consistent with the transferor's wishes and could lead to unexpected and unfair results. For example, assume that T bequeaths equal legacies to his three children, C-1, C-2 and C-3. C-1 owes T (and thus T's estate) an amount

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19. I.R.C. § 2041(a)(1) (1983).

20. I.R.C. § 2518(c)(2) (1983). (Under earlier law, the same result was achieved, since § 2041(a)(2) did not specifically treat a disclaimer of a power as a taxable release or exercise of the power).

21. *See* Rev. Rul. 64-62, 1964-1 C.B. 221. However, the disclaimant may be required to include the income in his taxable income where he had a right to receive or control the income prior to the disclaimer. *See* Grant v. Comm'r, 174 F.2d 891, 892 (5th Cir. 1949); Cleary v. Comm'r, 34 T.C. 728, 736-39 (1960).

22. *See* I.R.C. § 678(a)(1) (1983).

23. I.R.C. § 678(d) (1983).

24. *See, e.g.*, UNIFORM PROBATE CODE § 2-801(c) (5th ed., Official Text 1977); MASS. ANN. LAWS ch. 191A, § 7 (Michie/Law. Co-op 1981).

greater than his legacy. C-1 disclaims his legacy and obtains a discharge of the debt through bankruptcy. Assume further that, under state law, C-1's disclaimed legacy passes to his (C-1's) children. It is therefore conceivable, in some states, that C-1's children will receive the legacy undiminished by any setoff for C-1's debt.[25] This result may not coincide with the grantor's intent.

It thus becomes desirable for the estate planner to anticipate the disclaimer and to provide expressly for an alternative disposition, in the event of a disclaimer, which coincides with the transferor's wishes. In the example given above, the draftsman should clarify whether C-1's children will receive the property in the event of a disclaimer and whether the takers who receive the disclaimed property are subject to having the legacy reduced by the debts owed by the disclaimant to the estate. An express manifestation of intent as to an alternate disposition will be given effect and will override the statutory scheme that is usually operative only in the absence of such intent.[26]

A similar problem exists with respect to powers. The Internal Revenue Code expressly authorizes the disclaimer of powers.[27] Under some state statutes,[28] a disclaimer of a power does not result in the power passing to another person but, rather, causes an elimination of the power. This is undesirable if the transferor's objectives included a flexible and discretionary management of property and/or its beneficial enjoyment, and the transferor hoped to attain that end by a prudent exercise of the power. If an alternative donee is available, the estate planner may wish to designate an alternate holder of the power in the event of a disclaimer.

A disclaimer may also affect other interests in the property. Some state statutes,[29] for example, provide for an alternative disposition of the disclaimed interest but may not explicitly deal with the impact of a disclaimer of one interest upon other interests in the property, such as future interests.[30] Other statutes purport to come to grips directly with the problem. Thus, the Uniform Probate Code provides:

> A future interest that takes effect in possession or enjoyment after the termination of the estate or interest renounced takes effect as though

25. *In re* Colacci, 549 P.2d 1096 (Colo. App. 1976). *See also In re* Dankner's Estate, 86 Misc. 2d 1081, 384 N.Y.S.2d 683 (Surr. Ct. 1976) (disclaimer may be used to defeat claims of creditors and trustees in bankruptcy). In some states, however, a disclaimer may be barred if the party claiming is insolvent and the disclaimer would work a fraud on creditors. *See, e.g.*, Estate of Reed, 566 P.2d 587 (Wyo. 1981).

26. *See, e.g.*, MASS. ANN. LAWS ch. 191A, § 7 (Michie/Law. Co-op. 1981). Such an approach may not be available, of course, with respect to some interests that pass by operation of law to a survivors, such as joint tenancy property. *See also* UNIFORM PROBATE CODE, § 2-801(c) (5th ed., Official Text 1977).

27. I.R.C. § 2518(c)(2) (1983).

28. *See, e.g.*, MASS. ANN. LAWS ch. 191A, § 7 (Michie/Law. Co-op. 1981).

29. *Id.*

30. MASS. ANN. LAWS ch. 191A, § 7 provides that the disclaimed interest shall pass in the same manner as if the disclaimant had died immediately preceding the event determining that he is the beneficiary, and that such interest is indefeasibly vested. *Id.* It also provides that the "interest in property being disclaimed shall never vest in the beneficiary." *Id.* It does not explicitly treat the issue of the impact of the disclaimer upon other interests in the property, such as future interests. *Id.*

> the person renouncing had predeceased the decedent or the donee of the power. A renunciation relates back for all purposes to the date of the death of the decedent or the donee of the power.[31]

The Official Comment to the Uniform Probate Code states that this section has the effect of accelerating remainders.[32]

In states having no definitive rule as to whether acceleration occurs, it would certainly be prudent for the estate planner to spell out explicitly the effect of a disclaimer upon future interests. The same diligence is called for in states having an acceleration rule, since the statutory result may not coincide with the transferor's wishes. For example, assume that T leaves his estate in trust to pay the income to his son for life, the remainder to his son's children who survive him, and that the son disclaims with two children then living. Under the Uniform Probate Code, the remainder to the children accelerates and the trust terminates.[33] The two children, therefore, receive possession and enjoyment even though the son may subsequently have other children, or one or more of the two living children may die during the son's lifetime.[34]

Did T actually intend such a result? Did T desire to give the estate to the son's children even if they do not survive their father? Did T wish to exclude afterborn children of the son? Unless these matters are dealt with explicitly in a dispositive instrument, the transferor's actual intent may be a matter of pure conjecture. In addition, the statutory scheme may frustrate totally the effectuation of the transferor's planning objectives.[35] Therefore, despite the usefulness of disclaiming interests for the many reasons outlined above, serious questions remain as to the effect of such disclaimers on the transferor's intent.

FIDUCIARY DISCRETION—ESTATE PLANNING BY FIDUCIARIES

A number of provisions of the Internal Revenue Code sanction additional post-transfer estate planning devices which can, in some circumstances, enable an estate and/or its beneficiaries to achieve tax savings. The central role in this post-transfer estate planning theatre is played by the estate's fiduciary. The fiduciary's actions in this area may have a substantial effect on the economic benefits received by the intended beneficiaries of the transferor's wealth and may lead to results at considerable variance with the transferor's wishes. Two aspects of the tax law will be drawn upon to illustrate this point.

The Fiduciary's Election to Qualify Non-Marital Property for the Marital Deduction

Quite frequently, estate planning entails bifurcating the transferor's

31. UNIFORM PROBATE CODE § 2-801(c) (5th ed., Official Text 1977).
32. *Id.* (at Comment to Subsection (C)).
33. *Id.*
34. *Id.*
35. For a discussion of acceleration, see SCHWARTZ, *supra* note 12, at §§ 11.5 to 11.9 (Supp. 1982).

property into two portions consisting of a marital trust and a non-marital trust. The marital trust will provide that its income is payable to the surviving spouse for life and, in addition, will confer on the surviving spouse a general power to dispose of the corpus. The non-marital portion frequently will provide that the income is payable to the surviving spouse for life, with a remainder, upon the survivor's death, to the children of the marriage.

The provisions of the Internal Revenue Code now authorize the executor of the first decedent's estate to elect to qualify the non-marital portion for the marital deduction.[36] This election, if made, may totally insulate the first decedent's estate from federal estate taxation and defer the payment of the federal estate tax until the survivor's death. In such a case, since the estate will not be diminished by federal estate taxes, the election may enable the surviving spouse to receive more income than if the election had not been made. If the election had not been made, the non-marital portion may have been subjected to federal estate taxation, which normally would have been paid out of the non-marital portion.

On the other hand, the children may be adversely affected by the election. The election will defer the federal estate tax on the non-marital portion until the death of the surviving spouse. The property may appreciate substantially in value in this interim period. The federal estate tax will be based upon the value of this property at the survivor's death,[37] thus possibly reducing the net amount passing to the children.

The Fiduciary's Election of the Valuation Date for the Estate—
Estate of Colp

The Internal Revenue Code authorizes an executor to elect to value an estate, for federal estate tax purposes, at its value either on the date of the decedent's death or on an alternate valuation date—normally six months after the decedent's death.[38] Although this procedure was designed primarily to provide for the situation where a reduction in the value of estate assets during the period after the date of death has occurred,[39] its application is not limited to that situation.

Because of the generality of the scope of this provision, interesting and unexpected situations may arise, as exemplified by the factual circumstances in *Estate of Colp*.[40] In *Colp*, the assets of the estate were valued at approximately $1 million on the date of the decedent's death. The gross estate, as valued on the basis of the alternate valuation date, was approximately $1,100,000. The surviving spouse, who was also a co-executor, was the beneficiary of a preresiduary pecuniary formula marital deduction

36. *See* I.R.C. § 2056(b)(7) (1983). The election causes the property to be includible in the survivor's gross estate. *See* I.R.C. § 2044 (1983). However, the survivor's estate may have a right of recovery from the ultimate recipient of the property upon the survivor's death for the additional tax resulting from such inclusion in the survivor's estate. I.R.C. § 2207A (1983).

37. I.R.C. § 2044 (1983).

38. I.R.C. § 2032 (1983).

39. Estate of Ralph Colp, N.Y.L.J., January 20, 1976, at 8, col. 2 (N.Y. Surr. Ct. Nov. 3, 1975).

40. *Id.*

trust, which tied the amount of the marital deduction gift to the size of the estate for federal estate tax purposes. All estate taxes were payable out of the residue. The other executor, decedent's son by a prior marriage, was a residuary beneficiary. If the alternate valuation date was used, (1) the surviving spouse would have been entitled to a larger marital deduction; (2) the estate taxes would have been increased; (3) certain assets of the estate would have received higher income tax bases;[41] and (4) the estate's income taxes, arising from sales and the funding of the pecuniary trust with appreciated property, would have been decreased.[42] Combining the estate tax and income tax results, there would have been a net tax savings, after taking into account only realized gains, of approximately $8,500. On the other hand, since all estate taxes were to be paid out of the residuary estate, the residue would have been reduced, despite income tax savings.

Based on the foregoing calculations and considerations, the interests of the spouse and the residuary beneficiaries (and thus the interests of the co-executors) were diametrically opposed. If the alternate valuation date was used, the spouse would have benefited from a larger trust being established for her; if date of death values were used, the residuary estate would have been increased.

Although the court suggested some guidelines[43] for the resolution of this particular conflict, it did not necessarily resolve the issue for a case where neither of the beneficially interested parties is a fiduciary. More importantly, the facts of the case focus our attention on the broad power fiduciaries have to shift benefits from one legatee to another.

The broad powers of fiduciaries in this area must be viewed from the perspective of the courts' reluctance to second-guess a fiduciary's exercise of discretion.

> The general attitude of the courts has been that they will not upset the decision of the trustee, if it was made in good faith after consideration of the intent of the settlor as to the purposes of the trust and the circumstances of the beneficiaries at the time, even if the court would have taken different action or believes that a reasonable man would have come to a different conclusion. The settlor selected the trustee and intended that the beneficiaries should be content with his honest decision.[44]

In reality, fiduciaries are making important substantive decisions which significantly affect the beneficial enjoyment of the transferor's property. In a given instance, the fiduciary's judgment may or may not actually coincide with the transferor's scheme of disposition. The broad discretion afforded a fiduciary mandates that the transferor exercise considerable care and prudence in the course of selecting the fiduciary.

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41. *See* I.R.C. § 1014 (1983).

42. *See* Estate of Ralph Colp, N.Y.L.J., January 20, 1976, at 8, col. 2 (N.Y. Surr. Ct. Nov. 3, 1975).

43. *Id.* The court suggests that the estate must be viewed as a whole, without looking to benefit one beneficiary to the detriment of another, and that the executors owe the highest duty to the life beneficiaries (the son was a remainder beneficiary) of the residue. Furthermore, the court stressed that tax considerations should only be one factor in the executor's decision. *Id.*

44. *See* G. BOGERT & G. BOGERT, THE LAW OF TRUSTS § 89 (5th ed. 1973).

THE RATIONALITY OF FORMAL REQUIREMENTS FOR TRANSFERS

There can be no doubt that the revocable *intervivos* trust is one of the cornerstones of modern estate planning. Indeed, the author pleads guilty to advocating its extensive use.[45] Yet, the time has come for us to pause and ponder the strange anomaly existent in a comparison of the revocable trust and the will in terms of the law's formal strictures on the client's realization of his "expectation." A revocable trust may be utilized to transfer substantial wealth, or even the bulk of a transferor's property, without the trust being executed in conformity with the formal requirements incident to the execution of a will. Why should one mode of transfer be subjected to lesser or greater or different formal requirements? Although one may suggest that lesser formalities are justified in the case of a revocable transfer on the grounds that the revocable trust is a present, *intervivos* transfer, subject to subsequent revocation (and therefore not a death bed disposition), this is more of a conceptual than a substantive distinction. The settlor of a revocable trust may retain, for all practical purposes, as much control over his property as does a testator under a will during his lifetime. Indeed, the settlor of a revocable trust may prescribe simpler modes for revoking or amending the trust than are incident to the revocation or modification of a will.[46]

The view that the revocable trust and the will should be regulated in a consistent and uniform manner is an idea whose time has come. In the absence of supportive empirical data, however, I express no opinion as to whether the existing formalities governing the execution of wills or those pertaining to revocable trusts should be the surviving dominant model.

THE EQUITY AND LOGIC OF TRANSFER TAXATION

The question of "whose wealth is it anyway?" also poses the broad societal issue of the equity and rationality of governmental restraints, in the form of transfer taxes, upon an owner's capacity to dispose of his property as he sees fit. Consideration of these items is muddied by the presence of two major policy factors lurking in this area and by society's failure to delineate clearly whether transfer taxes are guided by one or both of these factors.

Policy Factors Behind Transfer Taxation

Are transfer taxes designed to raise revenue, or do they exist in order to redistribute wealth so as to prevent laggards and other less productive members of society from benefiting from an accumulation of wealth by others? The tax law has never clearly indicated which is the guiding principle or the extent to which either or both are intended to shape the direction of transfer taxation. Despite pious utterances and the nominally high rates of the transfer taxes, the transfer taxes do not appear to be doing an effective, rational or fair job of implementing either policy.

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45. *See* SCHWARTZ, *supra* note 12, at § 4.8 (1982 Supp.).
46. *See* 4 A. SCOTT, TRUSTS, § 330.7 (3rd ed. 1967).

The economist Lester Thurow has pointed out that, among those in the highest income group, 57% reported inheriting a substantial proportion of their assets, 66% reported some inheritance, and roughly 50% of the great fortunes are inherited.[47] Thurow concluded that loopholes in the transfer taxes have become so large that collections under these taxes have virtually ceased to exist, amounting to an annual wealth tax of 0.2%.[48] These taxes, he claims, do not prevent wealth from being transferred from generation to generation.

Thurow asserts that the basic problem is one of political power: "Are effective inheritance taxes zero because a democratic society decides that they should be zero? Or are zero inheritance taxes merely the best example of the political power that wealth can buy?"[49] Thurow's conclusions are supported by two case studies which dramatically illustrate the capacity of some holders of wealth to transmit it from generation to generation without serious diminution.[50]

Other studies also have cast doubts on the efficacy of transfer taxation. Statistics reveal that transfer taxes now constitute a smaller percentage of revenue collections than they did in 1970. In 1970, estate and gift taxes equalled 1.9% of all revenue collections, but only 1.3% in 1980.[51] Changes in the tax law in 1976 reduced estate and gift tax revenue by an estimated $1 to $1.5 billion annually,[52] and 1981 modifications in these taxes may result in only ⅓ of 1% of all estates being subjected to federal estate taxation.[53] In 1981, 199,000 gift tax returns were filed, and the gift tax generated $215 million of revenue.[54] In 1981, the gift tax annual exclusion was increased from $3,000 to $10,000.[55] As a result of this change, only 100,000 gift tax returns were filed in 1982 and only $108 million in gift taxes were collected in 1982.[56]

Are Transfer Taxes Equitable?

The transfer taxes also pose questions of equity. Three areas of tax law have been selected to illustrate these questions. First, under the tax law, life insurance proceeds can be arranged so as to be insulated from federal estate taxation.[57] As a result, about 30% of all life insurance proceeds are not subjected to estate taxation.[58] Does any public policy warrant Congress' creation of this oasis from transfer tax liability?

Second, living gifts and testamentary dispositions are now theoreti-

47. L. THUROW, GENERATING INEQUALITY, 130 (1975).
48. *Id.*
49. *Id.* at 197-98.
50. *See* Cooper, *A Voluntary Tax? New Perspectives on Sophisticated Tax Avoidance*, 77 COLUM. L. REV. 161 (1977).
51. STATISTICAL ABSTRACT OF THE UNITED STATES 256 (1981).
52. Pedrick, *Estate Planning and Future Shock*, 55 TAXES 226, 234 (1977).
53. THE STUDY OF FEDERAL TAX LAW, ESTATE AND GIFT TAXES 19.
54. 1981 COMMR I.R. AND CHIEF COUNS. I.R.S. ANN. REP., 5, 36 (1981).
55. I.R.C. § 2503 (1983).
56. 1982 COMMR I.R. AND CHIEF COUNS. I.R.S. ANN. REP. 7, 38 (1982).
57. I.R.C. § 2042 (1983).
58. *See* STUDY, *supra* note 53, at 17.

cally subject to the same unified rate structure.[59] The reason for this equalized treatment was a belief that "the tax burden imposed on transfers of the same amount of wealth should be substantially the same whether the transfers are made during life and at death or made only upon death."[60] Has this goal been achieved? The major loophole in the attainment of this objective is that a living gift may appreciate in value after the transfer and not be subjected to transfer taxation on the appreciation in value.[61] This affords the truly affluent, who can afford to make substantial *intervivos* gifts, a considerable advantage over others less fortunate.[62]

Third, the generation-skipping tax and its interplay with the rule against perpetuities raise questions of equity. Prior to the Tax Reform Act of 1976,[63] it might have been possible to defer the future imposition of an estate tax for a considerable period of time, despite the transfer of possession and enjoyment of the property through a number of generations. Thus, if O transferred property to A for life, then to B for life, then to C for life, then to D for life, and then to E for life, the property would not have been subjected to estate taxation on the death of each of the life tenants since none of the life tenants owned an interest in the property which was transmissible, at their death, by will or intestacy.[64] The major legal obstacle to the utilization of this scheme would have been the rule against perpetuities, which would invalidate a future life estate that might vest beyond the period of the rule.[65]

The Tax Reform Act of 1976 substantially changed this area of the law. It introduced a new concept and a new tax—the generation-skipping tax.[66] The House Report explains the reasons for this tax as follows:

> Your committee recognizes that there are many legitimate nontax purposes for establishing trusts. However, it also believes that the tax laws should be neutral and that there should be no tax advantage available in setting up trusts. Consequently, the committee bill provides generally that property passing from one generation to successive generations in trust form is to be treated, for estate tax purposes, substantially the same as property which is transferred outright from one generation to a successive generation.[67]

A generation-skipping trust essentially provides for benefits to be split between two or more generations which are younger than the generation of the grantor of the trust.[68] As explained in the House Report, "[t]he tax is

59. I.R.C. §§ 2001(c), 2502 (1983).

60. See H.R. REP. No. 1380, 94th Cong., 2nd Sess. 47, *reprinted in* 1976 U.S. CODE CONG. & AD. NEWS 3356.

61. I.R.C. § 2512 (1983). (If a gift is made in property, its value at the date of the gift is considered the amount of the gift).

62. This advantage is only partially offset by the fact that testamentary gifts, as distinguished from living gifts, receive a step-up in basis. *See* I.R.C. §§ 1014, 1015 (1983).

63. Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520 (1976).

64. *See* I.R.C. § 2033 (1983).

65. *See* Schwartz, *supra* note 12, at §§ 6.1 to 6.74.

66. *See* I.R.C. § 2601, added by the Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520, 1879 (1976).

67. H.R. Rep. No. 1380, 94th Cong., 2d Sess. 47, *reprinted in* 1976 U.S. CODE CONG. & AD. NEWS 3356, 3401.

68. *Id.* at 3401.

to be substantially equivalent to the estate tax which would have been imposed if the property had been actually transferred outright to each successive generation."[69]

Several exceptions under this tax law bring its equity and effectiveness into question. For example, many huge fortunes may be exempted from its application because of grandfathering provisions.[70] Other significant loopholes include trusts which have only one younger generation beneficiary,[71] outright gifts which skip generations and charitable lead trusts.[72]

The Continued Viability of the Rule Against Perpetuities in Light of the Generation-Skipping Tax

In addition, and of particular interest to the author, the existence of the new tax should cause us to reconsider the necessity and desirability of a rule against perpetuities. This question must be considered within the perspective of the reality that a violation of the rule can be avoided easily by draftsmanship. The use of a "standard savings" clause, to which all prior limitations are subject, insulates the instrument from a violation of the rule.[73] Such a clause essentially provides: No one shall be permitted to take an interest or share in any disposition unless his interest vests within 21 years after the deaths of A,B,C,D,E,F,G,H,I,J (ten healthy babies alive at the date the perpetuities period commences to run). Alternatively, the clause may require all trusts to terminate and distribution to be made within the perpetuities period.[74] If the generation-skipping tax will operate so as to reduce sharply the perpetuation of wealth through successive generations in any event, is it fair to punish the beneficiaries who are the innocent victims of sloppy draftsmanship?

The issue must also be considered within the framework of a judicial and legislative trend away from the rule against perpetuities. Thus, the modern judicial tendency is to take the presence of the rule into account in construing an instrument and to adopt a construction which avoids a violation of the rule.[75] Some states have adopted a "wait and see" statute which permits the court to take a "second look," as of the death of a life tenant, to see what actually happened between the creation of the interests and the termination of the life estate.[76] This type of statute eliminates some of the extreme applications of the common law rule.[77] In addition, some states have enacted limited[78] or complete *cy-pres*[79] statutes which validate interests that would otherwise violate the rule. If so many teeth have been

69. *Id.*
70. P.L. No. 94-455, § 2006(c)(1), 90 Stat. 1889 (1976), as amended by P.L. No. 95-600, § 702(n)(1), 92 Stat. 2935 (1978).
71. *See supra* notes 17 & 18.
72. *See* STUDY, *supra* note 53, at 775.
73. SCHWARTZ, *supra* note 12, at § 6.32.
74. *Id.*
75. *Id.* at § 6.22.
76. *See* MASS. ANN. LAWS ch. 184A § 1 (Michie/Law. Co-op. 1977).
77. *See* SCHWARTZ, *supra* note 12, at § 6.34.
78. *See* MASS. ANN. LAWS ch. 184A, § 1-2 (Michie/Law. Co-op. 1977).
79. *See* SCHWARTZ, *supra* note 12, at § 6.37.

taken out of the rule by these changes, one should seriously question whether the remaining objectives, if any, of the rule can be fully served by the generation-skipping tax.

One suggested policy justification for the rule is that it prevents an undue concentration of wealth in family dynasties.[80] Whether the generation-skipping tax will effectively redistribute wealth in society so as to displace this need for the rule remains to be seen.[81] The harshness of the tax is mitigated by credits,[82] deductions[83] and a $250,000 exclusion from generation-skipping transfers (per each "deemed transferor") for gifts to the grantor's grandchildren.[84]

In addition, many transfers which appear, at first blush, to be generation-skipping transfers, are not, upon closer scrutiny, subject to the tax. For example, assume that a grantor transfers property to his wife for life, and then to his great-grandchildren outright. Since the grantor's wife is assigned to the same generation as the grantor,[85] the trust would not be a generation-skipping trust. A generation-skipping trust must have "younger generation beneficiaries [younger than the grantor's generation] who are assigned to more than one generation."[86] In this case, there is only one younger generation represented in the trust. Such loopholes may prevent the generation-skipping tax from redistributing wealth to a significant extent.

Furthermore, the prevention of an undue concentration of wealth is not the sole justification for the rule against perpetuities. It has also been suggested that the rule is designed to prevent the control of property by the "dead hand" of the past.[87] The generation-skipping tax, however, may not effectively prevent control from the grave in a number of situations. For example, a gift to the grantor's children for their lives, with a remainder outright to such of the grantor's grandchildren as attain the age of 60, may not be subjected to a generation-skipping tax because of the $250,000 exclusion for gifts to grandchildren. On the other hand, such a gift could be validated by an application of a second-look or *cy-pres* statute. Furthermore, many of the gifts which involve the attempted imposition of outmoded values upon future generations involve the creation of possibilities of reverter and rights of entry. Some legislatures have already subjected

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80. *See* Leach, *Perpetuities in Perspective: Ending the Rule's Reign of Terror*, 65 HARV. L. REV. 721, 727 (1952).

81. H.R. REP. No. 1380, 94th Cong., 2d Sess. 8, Table 1 Fn. 1, *reprinted in* U.S. CODE CONG. & AD. NEWS 3362. The House Report estimated that the generation-skipping provisions would have no effect on revenue for 20 years. It was estimated that when the provisions become fully effective, after approximately 50 years, they would result in a revenue gain of $100 million per year.

82. *See* I.R.C. §§ 2602(c)(3)-(5)(B) (1976).

83. *See* I.R.C. § 2602(c)(2), added by the Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1879 (1977).

84. I.R.C. § 2613(b)(6), added by the Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1882 (1977).

85. I.R.C. § 2611(c), added by the Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1882 (1977).

86. See I.R.C. § 2611(b), added by the Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1882 (1977).

87. *See* SIMES, PUBLIC POLICY AND THE DEAD HAND 59-63 (1955).

such interests to a 30-year duration.[88]

It has also been suggested that the rule increases the marketability of property by eliminating uncertain future interests.[89] This rationale has limited validity with respect to a trust since a highly discretionary power of sale can be conferred upon the trustee. To the extent that it has any force, one must consider whether the generation-skipping tax will encourage more outright transfers in lieu of a series of successive life estates. Despite the tax, many transferors will still be tempted to create a series of successive life estates for purely non-tax reasons, such as lack of faith in the beneficiary's capacity to manage the property or a desire to provide benefits for successive generations. In addition, it should be noted that an outright transfer may result in the imposition of an estate tax upon the death of the transferee so that the transfer tax rate may not be reduced by refraining from making a generation-skipping transfer. Thus, the transferor may not be effectively dissuaded (from a tax perspective) from creating a series of successive life estates.

A resolution of the issue will necessitate an examination of the empirical data derived from examining the tax in operation. Until such data are accumulated and evaluated, it is to be hoped that this type of dialogue will be continued and broadened.

CONCLUSION

The focus of attention in this essay has been on impediments to the realization of an owner's objectives with respect to the disposition of his wealth. Some of the problems discussed may be resolved or mitigated by corrective action on the part of clients and their estate planners. A more effective communications process between estate planners and their clients would result in more informed decision making by the owners of wealth and written documents which more accurately reflect the transferor's wishes. The possibility of a disclaimer by a beneficiary can be anticipated and an alternative disposition explicitly provided for in the trust or will. Changes in the transferor's scheme of disposition caused by executor's elections may be reduced by circumscribing the fiduciary's exercise of discretion with external standards and/or by using greater prudence and care in selecting the fiduciary.

The solutions to certain other problems are more primarily within the grasp of the legislature. Congress must take a critical look at the policy foundations of our system of transfer taxation. Are the estate and gift tax laws designed to raise revenue and/or to redistribute wealth in society? In addition to probing these issues, Congress must face the questions of how equitable and rational the estate and gift tax laws are in implementing underlying public policies. State legislatures and the courts also have a role to play. Their efforts should be channeled toward evolving rational, formal requirements for transferring wealth and reexamining the viability

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88. See MASS. ANN. LAWS ch. 184A, § 3 (1976) (Michie/Law. Co-op. 1977).
89. *See* RESTATEMENT OF PROPERTY 2130 (introductory note at Division IV) (1944).

of long-established property rules, such as the rule against perpetuities, in light of changes in the tax laws.

Through the collective efforts of clients, estate planners, the courts and legislatures, society can improve its process of enabling the owners of wealth to achieve their expectations with respect to their property. It is a laudable undertaking because it culminates, in Bentham's terms, in the "happiness of society."