

**ALL RISE!**  
**PROBATE COURT IS NOW IN SESSION**  
**(A Case Study)**

**PRESENTED FOR**

**THE ATLANTA CHAPTER**  
**SOCIETY OF FINANCIAL SERVICE**  
**PROFESSIONALS**

**THE ESTATE PLANNING COUNCIL**  
**OF**  
**NORTH GEORGIA**

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### **National Advanced Solutions Director, the Principal Financial Group**

Steve Parrish is National Advanced Solutions Director for the Principal Financial Group<sup>®</sup>. With more than 30 years' experience as an attorney and financial planner, Parrish frequently addresses the challenges of business owners and executives nationwide.

Parrish is an expert on business owner financial planning, including buy/sell agreements and exit planning as well as executive compensation. He is a recognized industry authority, spokesperson and author serving as an ongoing columnist for Forbes.com and benefitspro.com. Parrish has served as an expert source for such prominent media outlets as *MarketWatch*, *Wall Street Journal* and *Journal of Financial Planning*. In addition to consulting with business owners and brokers, he is a sought-after speaker with industry organizations such as the Million Dollar Round Table and Association for Advanced Life Underwriting as well as various national business and financial organizations.

Parrish joined The Principal<sup>®</sup> in February 1997. Prior to that, he served as vice president, marketing services for AmerUS Life Insurance Company. He began his career as an attorney and advanced sales director in Minneapolis. He became a financial planner and agent in Atlanta, where he was a co-owner of Walker Parrish Financial Group. Steve received his B.A., Cum Laude, from Saint Olaf College and his Juris Doctor degree from the William Mitchell College of Law.

**Charlie Douglas, JD, CFP<sup>®</sup>, AEP<sup>®</sup>**

Sr. Vice President, Wells Fargo Private Bank

Charlie Douglas has practiced in the business, tax, estate and financial planning areas for over 25 years. As a senior vice president for a leading global wealth management institution, Charlie specializes in comprehensive planning solutions and trust fiduciary services for business owners, high net-worth individuals and their families. Charlie is a board member of the National Association of Estate Planners & Councils (NAEPC) and is the current editor of the NAEPC Journal of Estate & Tax Planning. The author of two books: *Awaken the American Dream & Rich Where It Counts*, and numerous articles, Charlie is a sought-after speaker on such topics as business ethics and morality in the marketplace, among others.

Mr. Douglas has over twenty five years of successful experience in financial, estate, corporate, tax and charitable planning, guiding affluent clients in growing, protecting and transferring their wealth. Today, he helps lead a wealth management team that specializes in comprehensive planning solutions and fiduciary trust services for business owners, high net-worth individuals and their families.

Before joining the Private Bank at Wells Fargo, Mr. Douglas held senior positions at various law firms and financial planning practices. Establishing himself as an expert in values-based planning and strategies for helping high net-worth families pass on a principled legacy,

A board member of the National Association of Estate Planners & Councils ("NAEPC"), Mr. Douglas is the current editor of the NAEPC Journal of Estate & Tax Planning

Sr. Vice President, Wells Fargo Private Bank April 2008 – Present

Specializes in comprehensive planning solutions and trust fiduciary services for business owners, high net-worth individuals and their families.

Editor, NAEPC Journal of Estate and Tax Planning 2010 – 2011

Owner, Charles Douglas Inc. January 2000 – April 2008 - Legal and financial planning practice specializing in estate, corporate, tax, and charitable planning for closely held businesses and high net-worth individuals.

**Charlie Douglas (continued)**

Books:

Awaken the American Dream, Possibility Press, 2004

Rich Where It Counts, Morgan James Publishing, 2006

Articles:

“Putting our Trust in Trusts,” CCH Journal of Practical Estate Planning, December 2010-January 2011;

“Finally! A New Tax Law...Now What?,” NAEPC Journal of Estate and Tax Planning, December 2010;

Insights on Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Leimberg Information Systems, December 2010;

“Bargain Transfer Rates Probable Through the End of 2010-Act Now!,” CCH Journal of Practical Estate Planning, August 2010-September 2010;

“Should Your Clients Consider Gifting Before the End of 2010,” Leimberg Information Systems, & NAEPC Journal of Estate and Tax Planning July 2010;

“Passing It on From the Inside Out,” CCH Journal of Practical Estate Planning, June 2008-July 2008;

“Where’s My Inheritance?,” CCH Journal of Practical Estate Planning, December-January 2006 & the NAEPC Journal of Estate and Tax Planning, November 2006;

“When a QPRT Becomes a Bad Hand,” CCH Journal of Practical Estate Planning, April-May 2006;

“Wealth Planning is More Than Money Planning,” CCH Journal of Practical Estate Planning, December 2005- January 2006

## **Pauline Reynolds, CPA**

**HLB Gross Collins, P.C.**

Pauline Reynolds has been with HLB Gross Collins, P.C. since 1987. She is a Cum Laude graduate of Georgia State University where she earned a Bachelor of Business Administration degree with a concentration in Finance and a Masters of Taxation.

For several years before joining HLB Gross Collins, P.C. Pauline worked for an investment counseling firm and in the trust department of a large regional bank.

### **Specialized Services**

Pauline specializes in taxation and personal financial planning with a particular emphasis on estate planning. She also works with a wide range of closely held businesses to incorporate the financial planning process for business owners and their business entities.

She has expertise in individual, partnership, trust, estate and corporate taxation, as well as IRS disputes and negotiations.

### **Community Involvement**

At Georgia State University, Pauline was a member of Beta Gamma Sigma Honor Society and received the Mortar Board Scholarship Award. She serves on the board of directors of the Epilepsy Foundation.

### **Professional Memberships**

In addition to earning the CPA designation, Pauline is a Certified Financial Planner and a Certified Merger and Acquisition Advisor. She is a member of the American Institute of CPAs and the Georgia Society of CPAs. She is also the Treasurer of the Estate Planning Council of North Georgia. In 2010 and 2011, Pauline earned the "**Five Star Award**" for wealth management, which allows consumers to identify professionals who have scored the highest in overall customer satisfaction.

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Doug Duncan is a principal in the law firm of Lefkoff, Duncan, Grimes, McSwain & Hass, P.C. in Atlanta, Georgia; specializing in areas of estate planning, trust and estate administration, taxation, executive compensation plans, and closely held business succession planning. Doug is a co-author of Will and Trust drafting forms published for lawyers, and has published outlines and articles on estate tax and generation skipping tax planning with life insurance, deferred compensation arrangements, estate planning for landowners, estate planning for owners of closely held businesses, and other estate and tax planning topics.

Doug has been a CLU (Chartered Life Underwriter) since 1972 and was for many years an instructor of the Advanced Estate Planning courses for the American College. He is the author and instructor of the Advanced Estate Planning course currently offered by the Atlanta Chapter of FSP, and is a Director and past President of the Chapter.

In addition to his regular law practice, Doug represents insurance agents and insurance companies as a consultant developing strategies in advanced underwriting matters, and is a frequent lecturer on matters of estate and tax planning for various professional groups. Doug is a member of the Society for Financial Service Professionals, The Association for Advanced Life Underwriting, The American Bar Association, and the Fiduciary Law Section of the State Bar of Georgia.

# THE FOOLISH DRAMA

## **General Background:**

Fred Foolish was a very successful entrepreneur who owned 100% of the outstanding shares of stock in a major independent oil and gas production company [“Big Deal, Inc.”], started in 1965 and recently appraised at \$30,000,000. He also owned significant ranching operations valued at \$10,000,000, and several residential and resort properties, with his primary home valued at \$3,000,000 and the remaining properties valued at \$4,000,000. Fred had amassed a stock/bond portfolio of \$10,000,000 despite his free-wheeling spending habits.

Through Big Deal, Inc., Fred had a pension plan account with a balance of \$2,500,000, a post-retirement supplemental executive plan of \$600,000 per year with guaranteed payments for 15 years to himself or his designated beneficiary, and a split-dollar life insurance policy with a face amount of \$5,000,000 (blended with a term policy to reimburse the corporation for its premium payments).

## **Fred’s Death:**

Fred died very unexpectedly on his 65<sup>th</sup> birthday, December 20, 2011.

## **Fred’s Extended Family:**

While Fred was very successful in his business pursuits, his personal life was a mess.

**First Marriage:** Fred married his high school sweetheart, **Betty Jo**, right after graduation. Their marriage produced two children, **Johnny**, now 46 and **Frannie**, now 45. Fred and Betty Jo were divorced after 12 years of marriage.

**Second Marriage:** Fred married a year after divorcing Betty Jo, this time to **Susan** who, unfortunately, was a witness in Fred’s prior divorce proceedings during which she was forced to admit her affair with Fred. Susan was the legal assistant to Fred’s long time attorney, drinking buddy and best friend,

Chuck. Chuck was one of the city's most prominent and colorful attorneys. Fred and Susan divorced two years later. No children were born to, or adopted by Fred and Susan.

**Third Marriage:** Fred met **Donna** on a hunting trip and ultimately married her 23 years after divorcing Susan. Donna was 30 years younger than Fred. They had two children, **Claude**, age 9 and **Bonnie**, age 7. At Fred and Chuck's insistence, Donna signed a Prenuptial Contract that was presented to her for the first time two hours before their marriage ceremony. She reluctantly signed it only after Chuck penciled in a provision that Fred would set up a trust for their children and fund it with \$1,000,000 per child, and would pay Donna a lump sum of \$2,000,000 if their marriage ended for any reason.

### **Fred's Estate Plan:**

**Donna's Probate Proceedings:** Prior to his death, Fred sent Chuck a memorandum with instructions to prepare a new Will whereby all of his vast Estate would be "divided equally" between his four children, Johnny, age 46; Frannie, age 45; Claude, age 9; and Bonnie, age 7; and with Donna (for her lifetime).

In addition, Fred's memo to Chuck further directed him to make sure Johnny ended up with Big Deal Inc., since he was the only child to work in the business, and that Donna will forfeit her interest if she ever remarries.

Chuck prepared the Will leaving a bequest of 50% of all assets to Donna in what he characterized as a "marital deduction trust" for her lifetime or earlier remarriage, a bequest of the Big Deal, Inc. shares to Johnny, and the balance of all assets equally to Johnny and Frannie.

Having kept the original of Fred's Will in his firm's vault, Chuck filed the Will for probate. The will appointed Chuck as executor and trustee, and directs the retention of his law firm to handle the probate.

Not trusting Chuck, Donna hired her own attorney to represent her interests. Donna's attorney immediately files papers with the Court presenting claims for payment under the Prenuptial Contract of (1) \$2,000,000 to Donna, and (2) \$2,000,000 for her children since Fred never set up the trusts. The attorney likewise files a copy of the deed to the home wherein title was held in the names of Fred and Donna.

**Betty Jo's Divorce Documents:** On the day of Donna's hearing, Betty Jo's attorney filed documents with the Court asserting that there was an Agreement Incident to Divorce (AID) between Betty Jo and Fred. The AID stipulated that Betty Jo would receive 25% of the proceeds from the sale of Big Deal, Inc., if and when sold by Fred to any person, and that therefore she was entitled to a "constructive (ownership) trust" on 25% of the shares

**Beneficiary Designations:** On the same day, Susan's attorney filed suit against Big Deal, Inc., attaching as exhibits the original beneficiary designation forms for the split-dollar life insurance plan signed by Fred. It designated Susan as the sole beneficiary. Further, no one has been able to find an executed beneficiary designation for Fred's pension plan account.

**The Mystery Woman:** With the turmoil throughout the probate procedures, another attorney filed papers with the Court on behalf on another woman, Candi Cane, age 22. Candi has in her possession (1) a hand written letter to the effect that Fred leaves her a previously unknown downtown condominium (valued at \$500,000), a Porsche automobile and \$2500 per month for life, and (2) another hand written note (this time on a bar napkin) stating that Candi "is entitled to" his post-retirement plan benefits.

**Ranch Foreman:** Fred's long-time ranch foreman, Tex, paid a personal visit to the probate Judge and explained that Fred and he shook hands on Fred's promise to Tex of a lifetime employment position and the right to lease his ranches if anything ever happened to Fred. Tex informed the Judge that Chuck was with Fred during the meeting.

**Ownership Documents:** There are deeds evidencing the ownership of the ranch property and the residence. The facts provide that they are held "jointly" with Donna, but there are at least three forms of joint ownership commonly found in the US and only two of them include a "right of survivorship."

**ALL RISE!**

**THE ESTATE OF  
FREDERICK FOOLISH**

**Presented For**

**THE ATLANTA CHAPTER  
SOCIETY OF FINANCIAL  
SERVICE PROFESSIONALS**

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August 8, 2012

# How is property transferred at death?

- form of ownership (jtwros, pod, etc.)
- contract (beneficiary designation)
- terms of a trust
  
- decedent's valid Will
- rules of intestacy

# Freddy's Assets

<u>Asset</u>	<u>FMV</u>
Stock in Big Deal, Inc.	\$30,000,000
listed securities	\$10,000,000
second home properties	\$ 4,000,000
Candi's condo	\$ 500,000
SERP plan	\$ 6,000,000
qualified pension	\$ 2,500,000
split-dollar insurance	\$ 5,000,000
ranch property	\$10,000,000
personal residence	<u>\$ 3,000,000</u>
Total	\$71,000,000

# Cast of Characters

- **Freddy's First Marriage:** Freddy married his high school sweetheart, **Betty Jo**, right after graduation. Their marriage produced **two children, Johnny**, now 46, and **Frannie**, now 45. Fred and Betty Jo were divorced after 12 years of marriage. Claims arising from the Divorce Agreement are described in #1 below.
- **Freddy's Second Marriage:** Freddy married a year after divorcing Betty Jo, this time to **Susan** who, unfortunately, was a witness in Freddy's prior divorce proceedings during which she was forced to admit her affair with Freddy. Fred and Susan divorced two years later. No children were born to, or adopted by, Fred and Susan. Susan's designation as the beneficiary of Freddy's life insurance was apparently never changed, as described in #3 below.

- **Freddy's Third (Last) Marriage:** Freddy met **Donna** on a hunting trip and ultimately married her 23 years after divorcing Susan. Donna was 30 years younger than Fred. They had **two children, Claude**, age 9 and **Bonnie**, age 7. At Fred and Chuck's insistence, Donna signed a Prenuptial Contract which is described further in #2 below.

- **The Mystery Woman:** With the turmoil throughout the probate procedures, another attorney filed papers with the Court on behalf of another woman, **Candi Cane**. Age 22, Candi has in her possession two hand written instruments described below which form the basis for her claim against the estate described in #6 below.
- **Ranch Foreman:** Fred's long-time ranch foreman, Tex, paid a personal visit to the probate Judge and explained that Fred and he shook hands on Fred's promise to Tex of a lifetime employment position and the right to lease his ranches if anything ever happened to Fred. Tex informed the Judge that Chuck was with Fred during the meeting. See discussion at #7 below.

# Claims Against Estate - 1

- **1966 Divorce Agreement** with first wife, **Betty Jo**, under which 25% of Big Deal, Inc. is held in trust and she is entitled to the proceeds from that stock if and when Big Deal is ever sold. Facts are not entirely clear, but this appears to be only a claim for a portion of sale proceeds, if and when Big Deal is sold, and not a claim of ownership of the actual shares. If her claim is founded on Betty Jo's release of marital or property rights, then it would be deductible for estate tax purposes pursuant to IRC §2053(e). It may be advisable to have court determine that this represents a valid claim for ownership of 25% of the Big Deal shares in order to optimize deduction.

# Claims Against Estate - 2

- **1989 Prenuptial Agreement** with third wife and widow, **Donna**. The agreement provides that she is to be paid \$2 million if the marriage ends for any reason, and requires Freddy to set up a trust for each of their children funded with \$1 million. The agreement was presented to Donna two hours before the marriage, when she was eight months pregnant, and she had no chance to confer with her own legal counsel. That circumstance might allow her to avoid enforcement of the agreement against her, but in this case she is the one who wishes to enforce the agreement. This does not appear to be a claim against any specific asset, but only a claim for monetary awards from the estate.

# Claims Against Estate - 3

- Beneficiary Designation applicable to the Split Dollar life insurance policy, designating **Susan** as the sole beneficiary. There is no evidence that the designation was ever changed or revoked, or that Susan waived her rights pursuant to their divorce settlement.

# Claims Against Estate - 4

- **Big Deal, Inc. Qualified Pension Plan**. We are told that there is no written beneficiary designation directing the distribution of the plan proceeds upon Freddy's death. However, in order to be a qualified plan, the plan document must provide that the "default" option for payment of benefits upon the participant's death is a qualified survivor annuity for the lifetime of the surviving spouse, unless the spouse has executed a waiver of that right. It is possible (and usual) that a well drafted pre-nuptial agreement will address the issue of the waiver directly, so the prenuptial agreement with Donna should be reviewed for such a provision. We assume here that there was no waiver, so that Donna is entitled to plan benefit.

# Claims Against Estate - 5

- Big Deal, Inc. SERP Plan. We are told that the plan provides for payment of \$600,000 per year for 15 years to Freddy or his beneficiary. We are not told that Freddy executed any beneficiary designation (other than the bar napkin described in 6 below), so it is not clear who has a claim on these proceeds. It is usual for the plan document to provide a "default" beneficiary, which might be the participant's surviving spouse, children, or the participant's estate. We will assume here that the default is Freddy's estate, so that the proceeds will be paid to the estate and then distributed under the terms of the Will (after resolving all claims against the estate). For federal estate tax purposes, the value of the annuity is the present value of \$600,000 per year for 15 years, determined using the interest rate provided in IRC §7520 at the time of Freddy's death. For purposes of this illustration, that value has been rounded to \$6 million.

# Claims Against Estate - 6

- Hand written letter allegedly given to Candi Cane by Freddy, "leaving" to her the condo, a Porsche automobile, and \$2,500 per month for life, and a hand written note on a bar napkin stating that Candi "is entitled to" the "post retirement plan benefits." The effect of these items is uniquely a determination of state law, but the legal theories could be (a) that they constitute a valid Will, (b) that they represent a contract, or (c) that the bar napkin is a valid beneficiary designation under the SERP.

- It is not likely that these rise to the level of a Will, because there are no witnesses by which the document can be proved ("probated") after the maker's death.
- It is also not likely that they are enforceable as a contract because a contract requires adequate "consideration" to be enforceable, and even a bargain for the "services" of Candi would be illegal and not provide consideration.
- Whether or not the bar napkin can be a valid beneficiary designation under the SERP might be a closer call, but it would surely require at least Freddy's signature which we are not told was on the napkin.

Therefore, it is assumed that none of Candi's claims are enforceable.

# Claims Against Estate - 7

- Tex's claim for a lifetime employment position and the right to lease the ranches if "anything ever happens to Freddy." We are not told the context in which the alleged "promise" was made, so we cannot determine whether there was any legal consideration to support a contract claim (such as Tex's agreement to continue working for Freddy, or to work for less compensation). Also, under applicable state law, certain kinds of contracts are required to be in written form in order to be enforceable. Contracts involving any rights in land usually fall into that category, as do contracts for services which might extend beyond one year. It is unlikely that either of these claims rises to the level of an

enforceable contract based on the information we are given, but that is a matter to be determined in a lawsuit. Unless some settlement can be reached, the Executor is likely to petition the court to determine whether there is any enforceable claim. Even if there is an enforceable claim, it is not a claim for the ownership of any estate property and would not change the manner in which the estate property is to be distributed.

# Documents and Claims - 8

- **Deeds** evidencing the ownership of the ranch property and the residence. The facts provide that they are held "jointly" with Donna, but there are at least three forms of joint ownership commonly found in the US and only two of them include a "right of survivorship." In most states, if the deed simply shows the owners to be "Frederick Foolish and Donna Foolish" then a "tenancy in common" is created which includes no right of survivorship. The deceased joint owner's fractional part of the property is a part of his estate. If, however, the deed shows the owners to be "Frederick Foolish and Donna Foolish as joint tenants with right of survivorship", or in some states "Frederick Foolish and Donna Foolish, his wife", then the ownership may be a "joint tenancy" or "tenancy by entirety" in which the surviving joint owner does succeed to the ownership of the entire property. We will assume here that there is a right of survivorship.

# Documents and Claims - 9

**Freddy's Will** (offered for probate) leaving -

1. a bequest of 50% of all assets to Donna in what is characterized as a "marital deduction trust" for her lifetime or earlier remarriage,
2. a bequest of the Big Deal, Inc. shares to Johnny, and
3. the balance of all assets equally to Johnny and Frannie.

Note that there is a question of whether the bequest of 50% of "all assets" to Donna's trust includes the Big Deal shares. For our purposes we will assume that it does.

# State Law

- With only a few exceptions, probate issues are creatures of state law, and all property law is state law. The federal law governs the estate tax system, but it is applied after the property ownership issues are determined under applicable state law. The primary exception in this case is the federal law which governs the rights of the surviving spouse as a beneficiary of a qualified plan account.
- Texas is a community property state, which adds layers of complexity to some of these issues not addressed in the materials and not within the scope of this analysis.

# Estate of Frederick Foolish

<u>Asset</u>	<u>FMV</u>	<u>How Does Each Asset Pass to Recipient?</u>				
		<u>Form of Ownership</u>	<u>Contract or Beneficiary Desig.</u>	<u>Separate Trust</u>	<u>Freddy's Will</u>	<u>Rules of Intestacy</u>
Stock in Big Deal, Inc.	\$30,000,000				\$30,000,000 <sup>1,9</sup>	
Listed Securities	\$10,000,000				\$10,000,000 <sup>9</sup>	
Second Home Properties	\$4,000,000				\$4,000,000 <sup>9</sup>	
Condo	\$500,000				\$500,000 <sup>6,9</sup>	
SERP Plan	\$6,000,000				\$6,000,000 <sup>5, 6,9</sup>	
Qualified Pension	\$2,500,000		\$2,500,000 <sup>4</sup>			
Split Dollar Insurance	\$5,000,000		\$5,000,000 <sup>3</sup>			
Ranch	\$10,000,000	\$10,000,000 <sup>7, 8</sup>				
Personal Residence	\$3,000,000	\$3,000,000 <sup>8</sup>				
<b>Total</b>	<b>\$71,000,000</b>	<b>\$13,000,000</b>	<b>\$7,500,000</b>		<b>\$50,500,000</b>	

\*\*Footnote numbers refer to “Documents and Claims” slide numbers above.

# Compute Estate Tax

Gross Estate	\$71,000,000
less Debts and Claims	
Betty Jo claim for 25% of Big Deal	(\$7,500,000)
less Administration Expenses	
costs of probate and administration	(\$250,000)
less Marital Deduction assets	
Residence	(\$3,000,000)
Ranch	(\$10,000,000)
Pension	(\$2,500,000)
Taxable Estate	\$47,750,000
Gross Federal Estate Tax	\$16,693,400
less Unified Credit	(\$1,730,800)
Federal Estate Tax Payable	<b>\$14,962,600</b>

# Estate Tax Notes

- Donna's 50% share of the residual probate estate to the “Marital Trust” will not qualify for the estate tax marital deduction because of the trust provisions which terminate her interest upon remarriage. That might be cured by a "settlement agreement" arising in the context of a challenge to the validity of the Will, in which the parties agree to revise the terms of the trust so that a QTIP election might be made.
- A large portion of the estate tax may be paid in installments over a 15 year period pursuant to IRC §6166, because a large part of the estate consists of an interest in Big Deal, Inc., a closely-held business.

# Distribution of Estate

<u>Asset</u>	<u>Betty-Jo</u>	<u>Susan</u>	<u>Donna (or "Marital Trust")</u>	<u>Johnny</u>	<u>Frannie</u>	<u>Claude</u>	<u>Bonnie</u>
Stock in Big Deal, Inc.	\$7,500,000		\$11,250,000 <sup>1</sup>	\$11,250,000			
Listed Securities			\$5,000,000 <sup>1</sup>	\$2,500,000	\$2,500,000		
Second Home Properties			\$2,000,000 <sup>1</sup>	\$1,000,000	\$1,000,000		
Condo			\$250,000 <sup>1</sup>	\$125,000	\$125,000		
SERP Plan			\$3,000,000 <sup>1</sup>	\$1,500,000	\$1,500,000		
Qualified Pension			\$2,500,000				
Split Dollar Insurance		\$5,000,000					
Ranch			\$10,000,000				
Personal Residence			\$3,000,000				
Award from Prenup Agmt.			\$2,000,000			\$1,000,000	\$1,000,000
Claim from Prenup Agmt.			(\$2,000,000)	(\$1,000,000)	(\$1,000,000)		
Admin. Expenses			(\$125,000)	(\$62,500)	(\$62,500)		
Estate Tax <sup>2</sup>		(\$1,566,764)	(\$6,697,918)	(\$4,798,216)	(\$1,272,996)	(\$313,353)	(\$313,353)
Income Tax on SERP			(\$577,500)	(\$288,750)	(\$288,750)		
	<u>\$7,500,000</u>	<u>\$3,433,236</u>	<u>\$29,599,582</u>	<u>\$10,225,534</u>	<u>\$2,500,754</u>	<u>\$686,647</u>	<u>\$686,647</u>

<sup>1</sup> Assets allocated to the "marital deduction trust" under Freddy's Will for Donna until her death or remarriage.

<sup>2</sup> Estate taxes are generally paid from the residual estate (unless the Will directs otherwise). However, for life insurance proceeds includible in the gross estate, IRC §2206 requires the recipient of the insurance proceeds to contribute their proportionate part of the estate tax liability attributed to the insurance.

# Can we do better?

## Consider -

- The “marital deduction trust” as written does not qualify for the marital deduction. It must, at a minimum, pay all net income to Donna at least annually for her lifetime. The clause which terminates her interest in the event of remarriage is adding \$7.5 million to the estate tax liability.

- A large portion of Big Deal, Inc. is not passing to Johnny, and probably will not pass to him after Donna's death. Johnny and Frannie are treated very un-equally, and their mother, Betty-Jo, has only an interest in Big Deal, Inc. with which to try to correct that.

# The Settlement Agreement Strategy

- In Georgia, if there is some basis on which Freddie's Will may be challenged, it is possible for all of the interested parties to settle that challenge by entering into an agreement for the disposition of the estate. That agreement is then entered by the court as Freddie's valid Will, controlling the distribution of the estate property.

- The Settlement Agreement will impact only the property which passes pursuant to the Will.
- The Settlement Agreement can “correct” drafting problems in the Will, which then becomes binding upon the IRS.

# Settlement Agreement Terms

1. If the parties can agree, the Settlement Agreement can re-write the “Marital Deduction Trust so that Donna is entitled to all the trust income annually for life. It will then qualify for the estate tax marital deduction as a QTIP trust.

# Settlement Agreement Terms

2. The revised marital trust can also mandate distribution of the remainder upon Donna's death, so as to better equalize the shares of the four children.
3. If Johnny is to "end up with Big Deal, Inc." then there needs to be some additional liquidity upon Donna's death.

# Settlement Agreement Terms

4. Big Deal, Inc. could redeem the shares allocated to the marital trust, and issue a promissory note equal to the value of the shares. The company apparently has substantial cash flow, from which it can pay interest on the note to provide income to Donna for life, and purchase insurance on Donna's life to pay the principal value at Donna's death.

# Settlement Agreement Terms

5. Upon Donna's death, the marital trust would receive cash, with which it can pay the estate tax due and divide the remaining assets so as to fairly equalize the shares of the children.
6. This would provide a "freeze" of the estate tax value of the shares in the marital trust for Donna's lifetime.

# Estate Tax Result

## Using Settlement Agreement

•	Gross Estate	\$71,000,000
•	<u>less</u> Debts and Claims	
•	Betty Jo claim for 25% of Big Deal	( 7,500,000)
•	<u>less</u> Administration Expenses	
•	costs of probate and administration	( 250,000)
•	<u>less</u> Marital Deduction assets	
•	Residence	(\$ 3,000,000)
•	Ranch	(\$10,000,000)
•	Pension	(\$ 2,500,000)
•	Marital Trust	<u>(\$21,500,000)</u>
•	Total	<u>(37,000,000)</u>
•	Taxable Estate	\$26,250,000
•	Gross Federal Estate Tax	\$ 9,168,400
•	less Unified Credit	<u>( 1,730,800)</u>
•	Federal Estate Tax Payable	<b>\$ 7,437,600</b>
•		
•	<b>Tax Reduction of \$7,525,000</b>	

# Estate Distribution After Settlement Agreement

<u>Asset</u>	<u>Betty-Jo</u>	<u>Susan</u>	<u>Donna (or Marital Trust)</u>	<u>Johnny</u>	<u>Frannie</u>	<u>Claude</u>	<u>Bonnie</u>
Stock in Big Deal, Inc.	\$7,500,000		\$11,250,000 <sup>1</sup>	\$11,250,000			
Listed Securities			\$5,000,000 <sup>1</sup>	\$2,500,000	\$2,500,000		
Second Home Properties			\$2,000,000 <sup>1</sup>	\$1,000,000	\$1,000,000		
Condo			\$250,000 <sup>1</sup>	\$125,000	\$125,000		
SERP Plan			\$3,000,000 <sup>1</sup>	\$1,500,000	\$1,500,000		
Qualified Pension			\$2,500,000				
Split Dollar Insurance		\$5,000,000					
Ranch			\$6,000,000				
Personal Residence			\$3,000,000				
Award from Prenup Agmt.			\$2,000,000			\$1,000,000	\$1,000,000
Claim from Prenup Agmt.			(\$2,000,000)	(\$1,000,000)	(\$1,000,000)		
Admin. Expenses			(\$125,000)	(\$62,500)	(\$62,500)		
Estate Tax <sup>2</sup>		(\$778,806)	\$0	(\$4,770,188)	(\$1,265,560)	(\$311,523)	(\$311,523)
Income Tax on SERP			(\$577,500)	(\$288,750)	(\$288,750)		
	<u>\$7,500,000</u>	<u>\$4,221,194</u>	<u>\$32,297,500</u>	<u>\$10,253,562</u>	<u>\$2,508,190</u>	<u>\$688,477</u>	<u>\$688,477</u>
Net Change →	\$0	\$787,958	\$2,697,918	\$28,027	\$7,436	\$1,830	\$1,830

# 706 Filing Deadline

- Form 706 (the Federal Estate and Generation Skipping Tax Return) must be filed within 9 months after the decedent's death unless otherwise extended.
- The due date is the day of the 9th calendar month after the decedent's death numerically corresponding to the date of the calendar month on which the death occurred.
- For example, Freddy died on December 20, 2011. The due date of the Form 706 would be September 20, 2012. (If there is no numerically corresponding day in the 9<sup>th</sup> month, then the last day of the 9<sup>th</sup> month is the due date.)
- Payment of the tax is also due at this time unless one of the provisions for extension of time to pay tax applies.
- Form 4768 extends the filing date for an additional 6 months, but does not extend the due date of the payment.

# Persons Required to File Return

- The duly qualified executor or administrator of a decedent's estate is required to file the estate tax return.
- If there is no qualified executor or administrator, then the persons in possession of the property of the estate are required to file the return.
- If there is more than one executor or administrator qualifying, then all listed fiduciaries are responsible for the return. It is sufficient, however, for only one of the co-fiduciaries to sign the return.

# Items Necessary to be Included with Estate Tax Return

- Certified Copy of the Will
- Certified Copy of Letters Testamentary
- Death Certificate
- Real Estate Appraisals
- Valuation of Closely Held Businesses
- Form 712 – Life Insurance Statement
- Trust Documents
- Gift Tax Returns

# Valuation Date

- By default, all property of the estate is included at its fair market value as of the decedent's date of death.
- If the estate qualifies and the representative chooses the alternate valuation method, then all property included in the gross estate is valued as of 6 months after the decedent's death, except that property sold, distributed, exchanged, or otherwise disposed of during the 6 months is to be valued as of the date of disposition.
- The use of the alternate valuation method is limited to situations in which the election would reduce both the value of the decedent's gross estate and the Federal estate and generation-skipping transfer (GST) tax liability of the estate.
- Once elected, the use of the alternate valuation date is irrevocable

# Marital Deduction

- An unlimited marital deduction is available for computing the taxable estate of an individual for the value of any property of the decedent's gross estate passes or has passed to the surviving spouse "in such a manner as to qualify".

# Estate Tax on Closely Held Business Interests

- The estate of an individual who dies owning a closely held business interest may qualify for a special elective method of paying the estate tax attributable to the interest – Section 6166.
- Effective for estates of decedents dying after 1981, estate tax attributable to a closely held business interest may be deferred for up to 14 years, with the estate making annual payments of interest only for the first 4 years and paying the balance in 10 annual installments of principal and interest.

# Estate Tax on Closely Held Business Interests

- This deferral is permitted only if the value of the business interest exceeds 35% of the adjusted gross estate.
- For purposes of the 35% rule, the adjusted gross estate consists of the gross estate less debts, expenses, claims, and deductible losses.
- In our example, Big Deal would qualify for Section 6166 treatment, since the value of Big Deal is greater than 35% of the adjusted gross estate

# THE END

## IRS Circular 230 Notice:

To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. tax advice contained in this presentation (including any written materials) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.