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When Estate Planning Gets Mugged by Reality: A Cautionary Tale of Our Times (Slides)

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When Estate Planning Gets Mugged by Reality

A Cautionary Tale of Our Times

positively unique



DIXON HUGHES GOODMAN LLP

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Background of Case

- Cantankerous Construction Company Owner
 - Mid 60's, fourth wife, three grown children
 - Post heart attack, cancer survivor
- Dabbles in Real estate and Restaurants
- Estate Planning done in 2005, remarried in 2008
- Major stroke in January 2012

Initial Estate Plan 2005

- Revocable Trust for Assets; Trust Assets to Children
- Irrevocable Life Insurance Trust \$2 million
- Company to Long time Employees
- Other business interests subject to buy-sell agreements
- \$3-\$4 Million in Cash and Securities

2008 Remarriage

- Marital and residence trust, in addition to family trust
 - Residence trust underfunded
 - Marital trust income only to much younger spouse
- Pre-nuptial agreement with limitations
- Trust amended by divorce attorneys
 - What overrides?-estate or pre-nup documents
- Limitations on rights of spouse

Change in Estate Taxes

Date of Death	Maximum Tax Rate	Taxable Estate Exclusion
2005	47%	\$1,500,000
2006	46%	\$2,000,000
2007	45%	\$2,000,000
2008	45%	\$2,000,000
2009	45%	\$3,500,000
2010	0%	Two options
2011	35%	\$5,000,000
2012	35%	\$5,120,000

Professional Continuity

- Death of Estate Attorney
 - Law Firm Change by Successor Attorney
- Responsibility for Custody of Documents
- Responsibility of Maintaining File
- Dealing with Electronic Environment
- What is default?

Current Pre-Stroke Environment

- Financial Pressures on Company
- Personal guarantees for extensive debt
- Lack of Succession Planning in entities
- Major health issues
- Not open financially with family
- Lack of liquidity

Medical Directive

- What/how it directs physicians
- What if that individual is unavailable?
- Is it assignable?
- How does state law provide for contingencies?

Conflicts of Interest in Estate Administration

- Malpractice carriers may limit CPAs from executor and trustee role
- Bankers and Brokers may be conflicted/prohibited
- Limitations from “beyond the grave” pre-nuptial agreement
- Sign-off of potential beneficiaries required
- Replacements may not know companies

Durable Power of Attorney

- Who directs business while owner is incapacitated?
- What degree of direction and decision making:
 - Can businesses be closed?
 - Can money be moved?
 - Can actions anticipate death?
- Transition from POA to executor

Life Insurance

- Notification steps/responsibilities of handling Crummey notices
- Corporate Life insurance vs. personal life insurance and prior spousal beneficiary
- Tax considerations on receipt
- Retention/Cancellation/Lapse of insurance
- Beneficiary Selection-Trust, Spouse, Child or Company
- Effect of Divorce

Liquidity

- Liquidity issues with cash needs right after death
- Time constraints on transfer of cash and what is needed (death certificate)
- Interim steps: payment of funeral, business expenses, loan payments
- Line of Credit—does Bank close it, who can draw on it?

Big Picture Problems Posed

- Limitations on cash flow vs. promises and expectations
- Is estate meant to last forever?
- Who is left to administer (crumbling) empire?
- Real estate holdings are illiquid, may be highly leveraged and held within jointly held entities
- Were assets properly titled in revocable trust?

Marital and Residence Trusts

- When funded? How deal in interim? What considered personal property?
 - Delay in payment to spouse or funding of marital trust due to illiquid nature of real estate may not be considered a material consideration. **IRS Letter Ruling 9125016**, Friedberg, Sidney Est, (1992) **TC Memo 1992-310**
- Understanding co-habitation rules

Other Assets

- 401(K)
 - What documents control? Effect of Pre-Nuptial. Difference between IRA designations and corporate designations if owned by company/ERISA
- Transfer of stock and bank accounts into trusts

Construction Company (S Corporation)

- Corporation now owned, in part, by trust. Per **Code Sec. 1361** estates are allowed to be S Corporation shareholders during the time required to perform the ordinary duties of administration. A testamentary trust is allowed to own S corporation stock for two year period after which the S election will terminate unless the trust qualifies as permitted shareholder.

Construction Company (continued)

- Allocation of income on ownership change
- Buy/Sell with minority shareholders-clarity of terms, tax effects on the new owners, who controls, pricing and funding
- Related party receivables
- Distributions from corporation and tax effect

Construction Company (continued)

- Financial statement issues regarding bonding, liquidity and guarantee of debt
- Line of Credit, payments due and ability to continue to draw
- Rent, is it at fair market value, who benefits?
- Trustee as company owner; liability of estate-debt, payroll taxes
- Who is left in charge?—authority to act
- Where is the Minute Book?

Restaurant (LLC)

- LLC with negative capital owned 75% by deceased held in revocable trust; basis step up considerations
- Personal and cross guarantees on line of credit
- Valuation of tangible property assets-possible gain on disposition

Restaurant (LLC)

- Technical termination considerations: 1) One remaining owner dissolves partnership 2) Change in ownership greater than 50%.
- When is the entity deemed closed: on owner's death; closing doors; or final disposition of all assets?
- Debt greater than assets

Restaurant (LLC)

- Loans from related parties
- Who operates closing business if minority owner steps back?
- Payroll, property and sales taxes and workman's comp: the responsibility of the estate for payment of outstanding balances

Pending Real Estate Handshake Deal

- Partnership or Joint Venture?
- Fiduciary responsibility of trustee to commit cash or walk away mid deal
- How report and where to report ultimate income?
- How to report value on estate tax return?
- Prior contributions from S corporation

Partnership Interests in Real Estate

- Valuation issues: overstated for bank, values down for estate
- Cross Collateralization and personal guarantee of debt
- Put Buy/sell in operating agreement; unfunded due to lapsed life insurance
- Documentation gaps in long term relationship

Partnership Interests (Continued)

- Can't force sale
- Illiquid partner
- Property upside down with debt
- Non permitted share transfers in loan agreements need approval to move into revocable trust

Partnership Interests (Continued)

- Considerations of income in respect of a decedent: Deceased partner's distributive share of partnership income to date of his death, including liquidation of partner's interest, sale of interest and partner's widow's payments as successor to spouse's rights.

Commercial Rentals

- Property in single member LLC
- Prior appraisals for bank purposes vs estate purposes
- Debt greater than FMV with personal guarantees that survive-how affects estate?
- Balloon mortgage-effect of work out

Commercial Rentals

- Upkeep and cash flow needs to consider: Lawn Care, Utilities-how to maintain until sale
- Property management transition from children-how long?
- Non-permitted loan transfer on death

Loans from Defunct Business

- Waterfall of Loan Guarantees-if other partner bankrupt
- Effect of S Corporation guarantee of debt-what survives death?
- Illiquidity of other partners-what rules under Virginia law?
- Renewal of loan
- Tax effect of write-down of loan

Foreign Property Holdings

- Condo in Costa Rica and bank accounts
- FBAR filings
- Possible trust considerations; foreign trust returns
- What if foreign business holding assets?

Charity

- Decedent's will says to give \$25,000 to the college that accepted his son
 - Potential funding issues

Special Elections to Consider

- Section 2032A Election to value qualified real property at value under which it qualifies as qualified real property; aggregate decrease in value shall not exceed \$750,000. Tax recapture possible within 10 years of transfer.
- Alternate Valuation date Election to value estate assets as of value six months after date of death; once made, the election is irrevocable.

Special Elections to Consider

- Section 6166 Election to pay estate taxes attributable to interest in closely held business that exceeds 35% of gross estate over 14 years by installment payments.
- Section 303 Redeeming closely held stock to pay estate tax on a tax favored basis as redemption of stock eligible for capital gains treatment rather than dividend.

Tax Returns to Consider

- Estate Tax Return (706)
- Final Individual return (1040)
- Estate or Trust (1041)
- Possible payroll tax returns-federal and state
- Property tax returns, business license, contractors license
- Sales and Use tax

20/20 Hindsight

- Stability of Current Marriage
- Treatment of his kids and her kids
- Need to review plan on life cycle events
- Annual update to Testamentary Letter
- Maintain inventory of all assets and liabilities

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