



Expiration without Taxation: The Strange Politics of Death in 2010

e-Legals is a periodic publication for friends and clients of The Rack Law Firm, P.C.

Providing Trusted Counsel in Matters Involving Estates, Trusts, Taxation, Elder Law, Estate Litigation and Business and Tax-Exempt Entities

Kevin B. Rack, LL.M.
[Taxation]

Flora T. Hezel, LL.M.
[Taxation]

Nathan R. Olansen, LL.M.
[Taxation]

Jennifer L. Moccia, LL.M.
[Estate Planning]

Nicole D. Morris, Esquire

Of Counsel
Michelle ReDavid Rack,
Esquire

When the recent death of ultra-wealthy Yankees owner George Steinbrenner brought the repeal of the estate tax to water-cooler conferences everywhere, there was a popular perception that 2010 was in fact “The Best Year in Which to Die.” However, these optimists may not have been warned that 2011 could prove to be the worst year in which to meet one’s demise since 2001.

Beginning in January of 2002, the now ill-fated Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) mandated sizeable, incremental increases in the individual estate tax exemption amount for individuals from \$1 million to \$3.5 million in 2009, while simultaneously lowering the maximum estate tax rate to 45%. Much to the surprise of lawyers and Capitol Hill observers alike, Congress allowed the estate tax to be repealed for 2010 when they allowed EGTRRA to “sunset” in the last effective year of the law. This meant that individuals with estates in excess of \$1 billion would pay no estate tax if they passed away in 2010 (most certainly the sort of legendary phenomenon that results in the bizarre concept that any year is a good year in which to die).

Calendar Year	Estate Exemption Amount	Highest Estate Tax Rate
2000	\$ 675,000	55%
2001	\$ 675,000	55%
2002	\$1,000,000	50%
2003	\$1,000,000	49%
2004	\$1,500,000	47%
2005	\$1,500,000	47%
2006	\$2,000,000	46%
2007	\$2,000,000	45%
2008	\$2,000,000	45%
2009	\$3,500,000	45%
2010	No Estate Tax	35%
2011	\$1,000,000	55%

If Congress once again fails to act, the estate tax is poised to return with a vengeance on January 1, 2011. Next year, anyone who dies owning assets in their estates valued at over \$1 million will be subject to estate tax at a maximum rate of 55%. After tallying up one’s real property, retirement accounts, life insurance death benefits and some savings or investments, it may come as a surprise for some to find they have a taxable estate (over \$1 million).

Stay tuned to the national news to see whether Congress will “extend the Bush tax cuts,” as it has been dubbed, or allow them to expire with the sunset. Whatever you do, we strongly encourage you to avoid the Steinbrenner estate tax plan and take a wait-and-see approach to 2011. Take heart, too, in the knowledge that Virginia is not imposing estate taxes, no matter what Uncle Sam may do.

The Buy-Sell Agreement: Asset Protection from Within Your Business

Every business plan should include a financially sound, well-documented arrangement to address the continuation of the enterprise in the event of the withdrawal, disability or death of one of the current owners.



The primary instrument, commonly known as the “buy-sell agreement,” governs the responses to multiple events and contingencies, including the terms of purchase and sale of the interests of that owner in the company. Specifically, the agreement establishes, in advance of the often crisis-filled trigger event, the obligations of the owners (and those of their estates or trusts) so that the remaining owner may have the certainty of funding the buy-out, and the withdrawing owner may depend upon the preservation of value of his or her interest. Needless to say, if the amount and source of payment, not to mention the details of the trigger events, for the purchase and sale are not negotiated before the need arises, then everyone concerned stands to lose.

The buy-sell agreement, in theory, is a proverbial “no-brainer.” Departing business owners want to ensure that they are compensated fairly for their interest in the entity, and remaining owners wish to avoid the burden of a substantial buyout. As for the dearly departed owners, the estate planning element of this agreement is to provide for the fair and timely purchase from their estate or trust, while surviving owners hope to preserve the continuity of ownership and management, rather than being forced into a business relationship with the successors of the deceased owner. In order to prevent future disputes regarding these critical terms of a buyout, preferences related to the sale and future management of the company may be resolved and reduced to writing by the business owners before they become either a survivor or a decedent. Enter the buy-sell agreement.

A properly drafted buy-sell agreement can achieve each owner’s goals by specifying and providing for the “trigger events,” upon which the departing owner will be guaranteed that his interest in the business will be purchased using a predetermined formula, while the remaining owners are guaranteed that they will have the opportunity to purchase such interest. The most common examples of trigger events are death, disability, retirement, bankruptcy and divorce. The bankruptcy or divorce of an owner could have a crippling effect on the business, and the required sale to the remaining owner avoids the complications of the legal proceedings by “cashing out” the troubled party. A well-drafted agreement will also establish an affordable and workable method of determining the purchase price of the departing owner’s business interest, including a preference for a recognized methodology of valuation for the departing owner’s interest (often used to reduce estate taxes). These terms may be hollow promises when the payment of the formula price comes due to the heirs of the deceased owner, so most agreements provide for a specific source of funding for the buyout (typically, a requirement to maintain an insurance policy on the life of each owner), which have the added benefit of preventing undue financial burdens on the survivors to the business.

The buy-sell agreement, when thoroughly negotiated and properly funded, can provide assurance to business owners that the loss of a partner will not lead inevitably to the loss of the enterprise. Moreover, these arrangements can provide the liquidity by which the departing owner’s family may apply to estate taxes and estate administration expenses which may arise. Once implemented, of course, the agreement can be revised to reflect changing circumstances and goals.

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Despite all of the obvious benefits of establishing a buy-sell agreement, many business partners tend to avoid these sometimes thorny or sensitive issues by paying lip service to the concept, deferring the discussion until the next shareholder meeting. Many owners do not broach the subject at all. Sometimes, a partner is uninsurable, making the plans for equitable funding of the buyout more of a challenge. Still, the buy-sell agreement has proven in practice to be well worth the time and effort, since it can provide confidence and security to each of the business owners and their families that both buyer and seller will benefit from the labors of building their enterprise, come what may.

TRIGGER EVENTS IN BUY-SELL AGREEMENTS

The mutual obligations in a typical buy-sell agreement are triggered when one of the owners:

- * Becomes Incapacitated
- * Retires
- * Becomes Legally Separated
- * Withdraws Involuntarily or is fired
- * Declares Bankruptcy
- * Becomes Dearly Departed

Welcome to Our New Associate !

When Nicole D. Morris sent her resume to the Firm seeking a position in her practice area of estate and trust administration, she could not have known that it was her cover letter that attracted my attention. Her skillful writing style (and her resume, of course) motivated me to invite her for an interview, even though we were not in the market to fill an associate attorney position. Soon after her visit, however, it was time to call her back for a second interview and an offer to join the Firm.



Nicole attended the College of Charleston for her B.S. in Economics and she earned her Juris Doctor at West Virginia University School of Law, where she was inducted into the Order of the Coif, an honorary legal scholastic society, and was the recipient of the Thomas N. Chamber Award in Taxation. She is a member of the Virginia State Bar, Virginia Bar Association and the Real Property, Probate, Trusts and Estates Section of the American Bar Association. Aside from the practice of law, Nicole is an avid reader and yoga enthusiast.

Mrs. Morris comes to us with experience in estate planning and administration in Virginia, as well as some very impressive writing skills. Please join us in welcoming Nicole to the team at The Rack Law Firm, P.C.

If you would like for any of our attorneys to speak to your group on a topic within our practice areas, please call Erin Hamberg at 757-605-5000.