

# ESTATE PLANNING

**Babirak, Albert, Vangellow & Shaheen, P.C.**

**Special Interest Articles:**

- The Decreasing Awareness of State Death Taxes
- Tax Apportionment Case
- Drafting life Insurance Trusts to Avoid Inclusion in Defendant's Gross Estate

**Individual Highlights:**

Yelverton Joins Firm  
Page 3

BAVS Joins BDO  
Seidman Law Firm  
Alliance  
Page 3

## Trust Modification Statute Utilized to Enormous Benefit of Heirs

In the recent Virginia case of *Tyler, et al. v. Bank of America, et al.*, a residuary beneficiary of a trust worth about \$20 million sought to expedite the distribution of trust assets. According to the terms of the trust, the trust was to pay income to six beneficiaries with the remainder to be given to their heirs upon the death of the sole remaining income beneficiary. Only one beneficiary is surviving today- a 77-year-old man in excellent

health. The challenging remainder beneficiary turned to the trust modification statute, Virginia Code § 55.1-19.4, to attempt to expedite her distribution. To satisfy the statute, the beneficiary had to show that a modification would be consistent with the intent of the settlor. Expert testimony was introduced showing that the one surviving income beneficiary should, according to actuarial accounting, have died five

to ten years ago. The trust likely had gone on, therefore, longer than the settlor had expected. It was also unlikely to the court, that the settlor envisioned the growth of the corpus from an amount under \$500,000 to approximately \$300 million. The court concluded, therefore, that the trust should be modified to better reflect the likely intent of the settlor.

## Witness Requirements for Will Execution

The recent Maryland case of *Slack v. Truitt*, 365 Md. 2; 791 A.2d 129 (2002), addressed the issue of whether a will signed outside the presence of witnesses should be admitted to probate even though one of the witnesses did not know he was witnessing a will and could not recall seeing the testator's signature on the document. The court found that the will was duly executed and could be admitted to probate because it is not necessary that a witness know that the document is a will, and a witness' inability to remember should not overcome the presumption of due execution. With regard to the will being signed outside of the presence of the witnesses, § 4-102 of the Estates and Trusts Article of the Maryland Code provides that "[e]xcept as otherwise provided in §§ 4.103 and 4-104, every will shall be (1) in writing, (2) signed by the testator... and (3) attested and signed by two or more credible witnesses in the presence of the testator." In the case of *Slack v. Truitt*, it was uncontested that the testator wrote his will and signed it, and that the witnesses signed the will in the testator's presence. The only question was whether the will was properly attested. The court found that the testator's will, which bore the testator's signature and the signature of two witnesses who, in the presence of the testator signed beneath the words "witnessed by," evidenced every indicia of due execution and thus, the testator was not required to sign the will in the presence of the witnesses and declare the document to be his will, or verbally acknowledge his signature to obtain a valid attestation.

## ***Babirak, Albert, Vangellow & Shaheen, P.C.***

### **Drafting Life Insurance Trusts to Avoid Inclusion in Decedent's Gross Estate**

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*"A recent IRS ruling, however, suggests that the IRS may be leaning toward a more flexible approach."*

Generally, if life insurance proceeds payable to an irrevocable trust are used to pay the deceased insured's debts or claims against his or her estate, such insurance proceeds are includible in the decedent's gross estate under the Internal Revenue Code § 2042. See *Estate of Davidson v. Commissioner*, 158 F.2d 239 (10<sup>th</sup> Cir. 1946); *Pacific National Bank of Seattle v. Commissioner*, 40 B.T.A. 128 (1939); *Estate of Logan v. Commissioner*, 23 B.T.A. 236 (1931). A recent IRS ruling, however, suggests

that the IRS may be leaning toward a more flexible approach towards the includibility of assets of an irrevocable life insurance trust in the gross estate of the deceased. In Private Letter Ruling 200147039 (Nov. 23, 2001), the IRS ruled that when the trustee of a decedent's life insurance trust merely had the "discretion" to use the proceeds of the life insurance policy to pay death taxes incurred by the deceased insured's estate, the insurance proceeds were not includible in the

decedent's estate unless the trustee actually used to proceeds to pay such taxes. A drafter of a life insurance trust, therefore, should be sure to state clearly that the trustee may, but is not obligated to, use insurance proceeds to pay death taxes or other claims against the deceased insured's estate. The end result should be that insurance proceeds will not be includible in the decedent's gross estate, unless the trustee actually uses the funds for the benefit of the estate.

### **Tax Apportionment Case**

In the U.S. District Court for the District of Maryland case of *Gordon et al. v. Posner et al.*, CSA No. 2295 (Dist. Md. Sept. Term 2001), the court held that the intent to opt out of the Tax Apportionment Act must be clearly stated by the testator. The Tax Apportionment Act, codified at § 7-308(b) of the Tax-General Article of the Maryland Code, provides how the federal estate tax and Maryland estate tax shall be apportioned among persons interested in an estate. It provides that "apportionment shall be

made in the proportion that the value of the interest of each person interested in the estate bears to the total value of the interests of all persons interested in the estate." The statute gives the testator an opportunity to opt out of the statutory directive. In *Gordon et al.*, the issue was the payment of estate taxes for the estate of a woman attributable to a Marital Trust created under the will of her late husband. The court found that the woman did not elect to opt out of the Tax Apportionment Act by a

statement in her will that estate taxes should be paid out of the "general assets of my estate without the right of reimbursement therefore whatever from any person or corporation." The residuary clause of the will, moreover, directed the disposition of the residue of her estate, "including all assets which are subject to my power of appointment pursuant to the Marital Trust created [under the will of my husband]." The court held that this failed to clearly state an intention to opt out of the Tax Apportionment Act.

## **Babirak, Albert, Vangellow & Shaheen, P.C.**

### **The Decreasing Awareness of State Death Taxes**

With so much recent focus on federal estate tax changes, transfer taxes imposed by states have been increasingly forgotten. Unfortunately, these taxes have not gone away. Most states impose death taxes in some form. There are three general types of taxes. 1) Inheritance tax is a tax that beneficiaries are assessed on the value of the assets inherited. Spouses and children are often taxed at a lower rate than other heirs. Many individuals specify in their wills that the estate shall pay these taxes; 2) State estate tax

is similar to the federal estate tax -- it is a tax on the right of an individual to transfer property at death. This tax is assessed against the value of the taxable estate; 3) Credit estate tax is referred to as a "sponge tax" because it piggy-backs on the federal estate tax. It is a credit against the federal estate tax for the amount of the state death taxes actually paid, up to a maximum dollar amount. This tax does not add to the estate owner's overall tax burden. Its purpose is to provide federal revenue credit to states.

The tax rates and types of transfer taxes vary by state. For example, Virginia does not have an inheritance tax or a state estate tax. It does, however, have a credit estate tax. The District of Columbia is the same. Maryland, on the other hand, has an inheritance tax, but not a state estate tax. Maryland, like Virginia and the District of Columbia, has a credit estate tax.



### **ANNOUNCEMENTS**

Babirak, Albert, Vangellow & Shaheen is pleased to announce The addition of Stephen Yelverton, as Of Counsel to the firm.

Stephen Yelverton has practiced law in Washington, D.C. for over 25 years and is AV-rated by Martindale-Hubbell. He is a graduate of the University of North Carolina at Chapel Hill with an A.B. and Juris Doctor degree, and has done post-graduate studies at the George Washington University Law School, Harvard Law School and Exeter College at Oxford University.

Mr. Yelverton started his legal career at the Federal Communications Commission where he served as a trial attorney and as Chief of one of the regulatory sections. After leaving the FCC, he entered private practices as member of one of the largest firms in North and South Carolina and served in their Washington, D.C. office. He started a telecommunications and media law practice for this firm and also engaged in legislative matters and Federal government contracts.

Mr. Yelverton's practice currently focuses on representing domestic and international high-tech and telecommunications companies in regulatory and business transactions and in government contracting. He is an active member of the British-American Business Association and serves on the High-Tech Business Advisory Committee for the Weizmann Institute of Science, which is based in Israel.

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As of March 1, 2002, Babirak, Albert, Vangellow & Shaheen has become a member of the BDO Seidman Alliance of Law Firms, a nationwide association of independently owned local, regional and boutique law firms with similar client service goals. BDO Seidman is a national professional service firm recognized as a premier tax consulting organization for more than 90 years. This Alliance will allow us to expand service opportunities for our clients by offering referrals to BDO Seidman for certain non-legal professional services.

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