

Factual Scenario
American Bar Association
San Francisco
September 16, 2005

John P. Smith died recently, survived by his wife, Mary L. Smith, and his two children of a prior marriage, Susan T. Ross and Lawrence W. Smith. John farmed his entire life, and remained active in the farming operation until his death. When he moved to a nearby small town, Susan and Lawrence assumed more of the daily farming obligations. They both intend to continue farming after John's death.

John specifically devised the family farm and the farm equipment equally to his children. The remainder of his estate passed as provided below:

Article 1: Taxes and Expenses. My executor shall pay all expenses of my last illness and funeral, costs of administration including ancillary, costs of safeguarding and delivering legacies, and other proper charges against my estate (excluding debts secured by real property or life insurance). My executor shall also pay all estate and inheritance taxes assessed by reason of my death, except that the amount, if any, by which the estate and inheritance taxes shall be increased as a result of the inclusion of property in which I may have a qualifying income interest for life or over which I may have a power of appointment shall be paid by the person holding or receiving that property. Interest and penalties concerning any tax shall be paid and charged in the same manner as the tax. It is my desire that any payment made pursuant to this article shall be charged against the residue of my estate, and I hereby waive for my estate all rights of apportionment or reimbursement for any such payments.

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Article 4: Residue. All the residue of my estate, wherever situated, including lapsed legacies, I give as follows:

1. 50 percent to my wife, Mary L. Smith, if she survives me;
2. 12.5 percent to my daughter, Susan T. Ross, if she survives me;
3. 12.5 percent to my son, Lawrence W. Smith, if he survives me; and
4. 25 percent to the University of Oklahoma Foundation.

If my wife or children fail to survive me, their respective gift shall lapse and shall pass to the University of Oklahoma Foundation. For purposes of this will, my wife and children shall be deemed to have predeceased me if the order of our deaths cannot be proved.

Attached is a copy of the inventory filed in John's estate. There were three assets which passed outside probate:

1. The decedent and his spouse owned a house in Muscatine as joint tenants with right of survivorship. The house was appraised at \$275,000.00, and there were

\$1,000.00 of accrued property taxes payable by the estate and deducted on Form 706.

2. The decedent and his spouse owned a condo in Florida as joint tenants with right of survivorship. The condo was appraised at \$325,000.00, and there were \$1,500.00 of accrued property taxes payable by the estate and deducted on Form 706.
3. The decedent owned a life insurance policy on his life, payable to Mary, which was valued at \$247,313.00 for estate tax purposes.

John's only debts were bills outstanding at the time of his death in the total amount of \$336.99 and an outstanding credit card balance of \$2,600.00. His estate incurred funeral expenses in the amount of \$3,820.00, executor fees in the amount of \$50,000.00, attorney fees in the amount of \$4,200.00 and miscellaneous administration expenses in the amount of \$2,284.00.

The estate has elected to value the farm land which passed to the children as provided in IRC §2032A(e)(7)(A). The average annual gross cash rental for the entire farm was \$142,500.00, and average annual real estate taxes was \$15,000.00, and the average interest rate for new Federal Land Bank loans was 6.80%. The farm equipment which also passed to the children had a value of \$124,000.00.

Under applicable state law, all taxes and estate administration expenses were charged against the residue, creating an interrelated calculation. In addition, the state in which the decedent died imposes a death tax equal to the federal credit for state death taxes as it would have been computed in 2001, based on the federal taxable estate as shown on the federal estate tax return, times a fraction, the numerator of which is the value of the property taxable in the state of residency and the denominator is the gross estate for federal estate tax purposes.

The attached returns assume two dates of death, 2004 and 2005. For purposes of both returns, we have assumed that Florida does not impose a death tax, although it would have imposed a tax for 2004 decedents.