

LEGAL UPDATE

CLIENT NEWSLETTER OF CARR, MORRIS & GRAEFF, P.C.

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ESTATE TAXES

2010 FALLOUT; 2011 & 2012 STOPGAP

Motivated by the 11th hour timing, Congress passed the Tax Relief Act of 2010 and President Obama signed it into law on December 20, 2010. The final version of the legislation keeps intact for two more years America's existing tax rate structure, temporarily fixes the AMT, and extends a number of deductions and tax credits, provides a temporary one-year reduction in Social Security taxes, temporarily reforms estate and gift taxes, and provides a number of incentives for businesses to invest in equipment. Concisely stated, for 2011 and 2012, the federal estate tax exemption will be \$5 million, and the estate tax rate for estates valued over this amount will be 35%. The estate tax has also become unified with federal gift and generation-skipping transfer taxes such that the gift tax exemption and generation-skipping transfer tax exemption will be \$5 million each and the tax rate for both will also be 35%.

Let's review the estate tax's evolution over the last decade (Year, Exclusion Amount, and Tax Rate): 2001 = \$675,000, 55%; 2002 = \$1 million, 50%; 2003 = \$1 million, 49%; 2004 = \$1.5 million, 48%; 2005 = \$1.5 million, 47%; 2006 = \$2 million, 46%; 2007 =

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ESTATE PLANNING

UK SUPREME COURT ENFORCES PRENUPTIAL AGREEMENT

Multinational corporations and public international organizations such as the World Bank often transfer staff to London for a tour of duty. Inevitably, the marriages of a certain percent of married employees fail and a divorce must be secured in the United Kingdom (UK). Until October 20, 2010, prenuptial agreements entered into by spouses who divorced in England were rarely enforced. Then on that date the new Supreme Court of the United Kingdom decided *Radmacher v. Granatino*, [2010] UKSC 42, enforcing a prenuptial agreement entered into by Katrin Radmacher and Nicolas Granatino.

The facts of the case are simple. The former spouses were married in London in 1998. The husband is French and the wife German. They entered into a prenuptial agreement before a notary in Germany three months before the marriage at the instigation of the wife, to whom a further portion of her family's considerable wealth would be transferred if an agreement were signed. She is one of Germany's wealthiest women with a fortune in the hundreds of millions of Euros. The agreement was subject to German law and provided that neither party was to acquire any benefit from the property of the other during the marriage or on its termination. The husband, who at the time worked as a banker, declined the opportunity to take independent advice on the agreement. They separated in October 2006 after eight years of marriage. They have two daughters, born in 1999 and 2002. By this time the husband had left banking and had embarked on research studies at Oxford University.

The husband applied to the courts for financial relief. In the High Court (trial court) he was granted a sum in excess of £5.5 million sterling which would afford him an annual income of at least £100,000 sterling for life and allow him to buy a home in London where his children could visit him.

The judge took into account the existence of the prenuptial agreement but reduced the weight she attached to it because of the circumstances in which it was signed. The wife appealed successfully to the Court of Appeal, which held that in this case the agreement should have been given decisive weight. The husband should only have been granted provision for his role as the father of the two children and not for his own long term needs. The husband then appealed to the Supreme Court.

The Supreme Court (by a majority of eight to one) dismissed the husband's appeal. Writing for the majority, Lord Phillips observed it used to be contrary to public policy for a couple who were married or about to be married to make an agreement which provided for the contingency that they were about to separate, on the basis this might encourage them to do so, and the courts paid no regard to them. After 1957, separation agreements were given considerable weight, as increasingly were postnuptial agreements, in marked distinction to the treatment of prenuptial agreements. Nevertheless, the courts were entitled to overrule the agreements in either case. The question in this case was how the court should approach the task of deciding what weight should be given to a prenuptial agreement.

English law on prenuptial agreements differed significantly from the law of Scotland, the rest of Europe and most other countries. Most jurisdictions accord contractual status to such agreements and hold the parties to them, subject to safeguards or exceptions. Under English law, however, the court was the arbiter of the financial arrangement between the parties when the marriage came to an end. A prenuptial agreement was only one of the matters to which the courts have given regard.

In this case the Supreme Court enunciated three principles. First, parties must enter into a prenuptial agreement voluntarily, without undue pressure, and be informed of its im-

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ASK A LAWYER, Q&A

Q: I have a small medical practice in Virginia. Recently, an office worker came to work in a Pittsburgh Steelers jersey. When I asked her to dress more professionally, she told me she had a Constitutional right to express herself and that anything I did or said would be illegal discrimination. She says her sister's husband is a lawyer. By the way we don't have written office policies or an office manual. Was I wrong to ask her to dress better? May I terminate her, or would that be illegal retaliation?

A JETS FAN IN ASHBURN

A: Your staffer shows poor taste wearing a Steelers jersey within field goal range of the Skins' practice facility. More to the point, she's wrong for several reasons—and, yes, you may insist that your staff dress professionally. There are, however, a few exceptions to your authority to place dress code requirements on your staff. The most common exception deals with dress mandated by a person's religion; legitimate religious beliefs may require a head or face covering, loose fitting clothes or some other piece of attire with religious significance. Policies cannot be put in place which restrict an employee's ability to follow his or her religious beliefs unless there is a legitimate safety reason for the policy. For instance you can prohibit loose fitting clothes for employees who work in the vicinity of machinery with exposed moving parts and can require certain types of head coverings when working in food service.

While your concern with retaliation is appropriate, it should not be a concern in this instance. "Retaliation" refers to job action taken in response to an employee asserting *legally protected rights*. For instance, if the employee were wearing a clothing item in furtherance of a legitimate religious belief, it would be impermissible retaliation to discharge the employee after the employee claimed the objectionable clothing was religious in nature. Even in Pittsburgh, Steelers fandom is not actu-

ally a religion. Assuming the employment relationship is *at will*—almost certainly the case with a temp—you are free to terminate this employee. (Practically, since this individual is a temp, you also have the available option of asking the placement agency for a new candidate.)

This type of question is yet another reason to have established, written employment policies. If you had written employment policies, you could have simply pointed the employee to the policy requiring professional attire. If your employee continued to resist your guidance, you might then direct the employee to the policy of *at will* employment.

Q: I work in a large auto detailing shop in Maryland. Prior to the recent NFL playoffs, a few of us organized a pool. Because the buy-in was under what I had always heard was the legal limit—\$100 per participant and no more than 100 participants—I saw no problem. My boss disagreed and ordered me to abandon the pool. The first round had already been completed when my boss pulled the plug, so the dozen players (out of 99) who actually picked the Seahawks over the Saints are upset; they all thought they had a big leg up by picking an early upset. Can I sue my boss?

BUFFER IN BETHESDA

A: Buff, your boss did you a favor. Outside of the union work environment, employers are permitted to unilaterally make and enforce work rules and policies. The only restriction on employer work rules is that they may not be discriminatory. Rules prohibiting gambling on work premises or during working hours are very common. Your employer took it easy on you by simply pulling the plug on the pool. He just as easily could have pulled the plug on your buffer and told you to find a new job. By the way, your schoolyard rule-of-thumb regarding the allowable scope of betting pools has no basis in law.

PHILIP SCHWARTZ**DISCRIMINATION
ATTORNEYS' FEES
RECOVERED BY FIRM
WRONGLY ACCUSED OF
DISCRIMINATION**

In something of a man-bites-dog scenario, an employment discrimination claimant first lost her case, then was ordered to pay over \$28,000 in court costs and attorneys' fees. In the matter of *Basinger v. Hancock, Daniel, Johnson & Nagle, PC*, U.S.D.C.No.Va. No. 1:10cv666 (Dec. 23, 2010), U.S. District Judge Leonie M. Brinkema determined that secretary Judith Basinger's retaliation claim against the law firm she worked for—and which terminated her—was frivolous, groundless and unreasonable, thus justifying an award of fees and costs to the prevailing party.

Ms. Basinger's claim—and the law firm's nightmare—began when the 51-year old Basinger expressed unsolicited social interest in a 31-year old male associate of the firm. Several inappropriate emails clearly demonstrated Ms. Basinger's misconduct; yet, she declined the firm's efforts to mollify the situation by transferring her to another office. When the firm terminated her, Basinger claimed discrimination for retaliatory action. The court rejected Basinger's unsupported claim that she was the victim of harassment, noting, among other things that she had not complained, that it was not Basinger who instituted the investigation, and that she did not produce incriminating emails she claimed to have received. Moreover, Ms. Basinger offered no persuasive proof of adverse action by the firm. The law firm had offered to transfer her to another office that was no less convenient to her home.

ESTATE TAXES*Continued from page 1*

\$2 million, 45%; 2008 = \$2 million, 45%; 2009 = \$3.5 million, 45%; 2010 = Repealed, 0%; and 2011 = \$5 million, 35%. Which year was the most advantageous to pass away? For the 95%+ of us who are not subject to the tax, any year would be equally fine. For George Steinbrenner, 2010 was probably the optimal year. For the married couple with a high seven-figure net worth, 2011, not 2010, is probably preferable. Here's why.

The estate of someone who died in 2010 would avoid all estate taxes. But heirs are subject to the "carryover basis" on all assets they inherit¹. That means that the heirs take the same tax basis the decedent had. When the heirs sell the asset, they will pay a capital gains tax on all the appreciation that occurred since the decedent acquired it. For example, your parents' Exxon Mobil stock, purchased in the 1960's with a basis of \$2,000 is now worth \$800,000. When you inherit the stock in 2010, your parents' estates do not pay any tax; but, when you sell it, you will pay capital gains tax on difference between the basis (\$2,000) and the current market value. Under 2011 estate tax rules (and the pre-2010 rules), the heirs receive a "stepped-up basis" for the property. The heirs' tax basis in the property is its fair market value on the date the decedent died, and the parents' estates would only pay estate tax if their estate exceeded the exclusion amount.

Recognizing that 2010 is a true outlier in estate tax law, Congress included flexibility for estates of decedents passing away in 2010. The new estate tax rules are available for the estates of those dying after 2009. The new law gives the executors of estates of those who died in 2010 an option; they can choose the 2010 rules (no estate tax but carryover basis for heirs) or the new rules (estate tax above exclusion amount and stepped-up basis for heirs). For estates worth \$5 million or less, electing the 2011 rules is sure to be the right choice. For larger estates, it is not clear; tax calculations must be performed comparing the estate tax that may be owed under the 2011 rules and the capital gains taxes heirs would owe under the 2010 rules when they eventually sell the assets.

An additional wrinkle of the new law concerns the portability of the exclusion amount between spouses. In pre-2010 estate tax law, the estate tax exclusion amount was available only for the individual; it was either use it or

lose it. For example, take 2008 with a \$2 million exclusion amount, for a married couple with a combined net worth of \$3 million. If the husband dies first and left everything to his wife (there are no estate taxes on bequests to spouses regardless of amount), she would then have an estate of \$3 million – his exclusion amount then disappears. When she passes away later in 2008 with an exclusion amount of \$2 million, \$1 million of her \$3 million estate would be subject to estate tax. Our estate planning solution has been to allow the husband to leave his estate (\$1.5 million) to a Credit Shelter Trust for the wife's benefit, and then to their heirs on her death. It is not included in the wife's estate, thus her estate is limited to \$1.5 million. The entire \$3 million can now pass to the heirs free of estate tax (\$1.5 million through the Credit Shelter Trust, and \$1.5 million through the surviving spouse's estate). To a degree, the new law *temporarily* circumvents the need for this level of tax planning. Under the new law, *in 2011 and 2012*, a surviving spouse generally can use the unused exemption of the first spouse to pass away. This means that under the 2011 and 2012 rules a couple has a \$10 million estate tax exclusion regardless of how ownership of the assets is allocated.

It is unclear how this will work in practice, and rules will be drafted for when an individual has survived multiple spouses. Additionally, the Tax Relief Act of 2010 is a temporary fix. Therefore, given that estate tax is always changing and will be rewritten again prior to 2013, it is best to still include traditional estate tax planning methods. Stand pat in the interim.

JUSTIN BANFORD**ESTATE PLANNING***Continued from page 1*

plications. The question is whether there is any material lack of disclosure, information or advice. Second, in 1998, when this agreement was signed, the fact that it was binding under German law was relevant to the question whether the parties intended the agreement to be effective. After the court's decision in this case, it will be natural to infer parties entering into agreements governed by English law will intend that effect be given to them.

Third, and most importantly, a prenuptial agreement may make provisions which conflict with what a court would otherwise

consider to be fair. The principle to be applied is that a court should give effect to a prenuptial agreement which is freely entered into by each party with a full appreciation of its implications unless, in the circumstances prevailing, it would not be *fair* to hold the parties to their agreement. A prenuptial agreement cannot be allowed to prejudice the reasonable requirements of any children of the family, but respect should be given to individual autonomy and to the reasonable desire to make provision for existing property. In the right case a prenuptial agreement can have decisive or compelling weight.

Applying these principles to the facts, the Court of Appeal was correct to conclude there were no factors which rendered it unfair to hold the husband to the agreement. He is extremely able and his own needs will in large measure be indirectly met from the generous relief given to cater for the needs of his two daughters until the younger reaches the age of 22. Moreover, the husband's decision to abandon his career in banking to pursue one in academia was not motivated by the demands of his family but reflected his own preference. Fairness did not entitle him to a portion of his wife's wealth, received from her family independently of the marriage, when he had agreed he should not be so entitled when he married her.

The Supreme Court's decision in this case brings England into the mainstream of legal principles applying to prenuptial agreements worldwide. English exceptionalism in this regard had made England the divorce capital of the world with attendant forum-shopping. Parties with tenuous contacts with Britain attempted to secure divorces there when they desired to break a prenuptial agreement entered into elsewhere. The decision does not enunciate a *per se* rule. In fact, there is no *per se* rule applying generally to prenuptial agreements. Rather the general rule is similar to the one the court announced: a prenuptial agreement freely entered into by an adult with knowledge of his future spouse's wealth and the opportunity to consult counsel should be enforced. Obviously, to avoid litigation we advise our clients to give each other full financial disclosure and ensure both parties have separate attorneys reviewing the agreement and advising each prospective spouse.

NÉSTOR CRUZ

**CARR, MORRIS
& GRAEFF, P.C.**

Carr, Morris & Graeff, P.C., was established in 1982 by the named principals—Lawrence Carr, Roy Morris and Stephen Graeff. It is a diversified firm structured primarily to meet the legal needs of businesses and their principals.

The firm strives to provide full service representation to its corporate and individual clients. It is designed to provide such service by organization and presentation of an array of attorneys with diverse backgrounds in specialized areas of the law as well as a generalized background which enables them to look beyond a narrow specialty or need. The academic and cultural backgrounds of the attorneys of the firm are as diverse as their experience and specializations.

Carr, Morris & Graeff, P.C., specializes in the following areas: Corporate/General Business; Taxation/Estate Planning; Civil/Commercial litigation; Employment/Labor; Discrimination and Wage-Hour; Criminal; and Alternative Dispute Resolution.

The firm maintains its office in Tysons Corner, Virginia—the business hub of the metropolitan region. It has attorneys admitted to all of the local judicial jurisdictions.

STAFF NOTES

Fun in the sun. With memories of Snowmageddon '09-10 still haunting Washington area residents, CMG lawyers this winter have been looking south for a break. Larry Carr made a brief visit to Arizona, while Roy Morris, Phil Schwartz and Dana Theriot all headed to Florida.

* * *

Back on the horse. Roy Morris has recovered nicely from his recent shoulder injury, well enough to resume his longstanding practice of bicycling to the office.

* * *

Happy Birthday to Us. March 1 marks the firm's 29th anniversary.

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