

# Scenario 3

## Brenda and Eddie

### Family Circumstances

Brenda (age 56) and Eddie (age 60) have been married for many years and have a close-knit family comprised of themselves and four children:

Andrew (age 35) who is an officer in the U.S. Navy and intends to remain in the Navy for as long as they will keep him. Andrew is married and has 2 children. He is currently stationed with his family in Guam.

Bobby (age 32) who is bi-polar and suffers from various substance abuse issues. Bobby works, but he can't stay employed at any one job for very long. Brenda and Eddie contribute to Bobby's support and figure they will be required to continue to do so throughout Bobby's lifetime. Bobby is currently in the process of divorcing his second wife. Fortunately, Bobby has never had any children (that he knows of).

Chuck (age 29) who is a professional crewman on racing America Cup-type sailboats. Chuck loves what he does and has no immediate intention to discontinue his around-the-world lifestyle. Chuck finished high school, but never finished college. He is unmarried and has no children yet.

Doug (age 21) is a junior in college who is majoring in business administration. He has a significant girlfriend, but they have no immediate marriage plans.

About two years ago, Brenda was diagnosed to have breast cancer. After two years of treatment, she is currently in remission and considers herself a breast cancer survivor.

### Financial Resources

About 20 years ago, Brenda inherited a full service marina ("The Boatyard") from her late father. Prior to her father's death, she served as his bookkeeper and right hand person. Since her father's death, she has actively managed the marina as the hands-on President and CEO of an S corporation ("The Boatyard Inc.") owning all of its business assets other than the land, slips, and riparian rights on which it is operated. Brenda individually owns 100% of the issued and outstanding stock of The Boatyard Inc.

Brenda and Eddie own as tenants by the entirety the land, slips, and riparian rights on which The Boatyard is operated. The real estate is included in an Anne Arundel County MB zoning district and is currently commercially assessed by the State of Maryland for \$4.7 million. The real estate is currently encumbered by a \$3 million loan for past site improvements (slips and piers, boat storage racks, and working shed facilities that are rented out to various yacht tradesmen, as well as a very large boatlift and other equipment used as a part of the business of The Boatyard Inc.). Each of the past 5 years, Brenda and Eddie have been working diligently to retire as much of this encumbrance as they believe possible. After years of prior depreciation, the land, slips, and riparian rights owned by Brenda and Eddie have a capital gains basis of \$400,000.

The Boatyard is fortunate to be located in close proximity to the Washington and Baltimore metropolitan areas, the Chesapeake Bay, and prime sailboat racing and fishing areas on the Bay. As a result of its location and Brenda's diligent efforts to plow back revenues into marina profit centers, The Boatyard is very successful. For the last four years, the earnings of The Boatyard's business activities (including renting the slips and working shed facilities owned by Brenda and Eddie) have netted approximately \$900,000 per year over its expenses and have each year increased over the preceding year by about 5-7%. After depreciation, the equipment and other tangible personal property owned The Boatyard Inc. has a book value of \$800,000 and a capital gains basis of just over \$1,000,000. On the basis of these revenues, Brenda and Eddie think that The Boatyard may be worth as much as \$9,000,000 to \$10,000,000.

Brenda pays herself a salary of \$45,000 per year, but The Boatyard Inc. does declare and pay her annually a dividend each year of some \$255,000 (plus whatever is needed to pay her income taxes on The Boatyard's net income). That dividend has been paid consistently for the past 10 years. The balance of its profits are plowed back into the business, either for debt retirement, leasehold improvements, or the purchase of equipment. Aside from her salary and customary insurance benefits, Brenda's primary perk from her position is that The Boatyard owns and maintains an old wooden 60 foot sailboat ("Summer Time") that Brenda and Eddie often live aboard during summers. The sailboat is kept in such good condition that its book value on the company's financial statements is some \$150,000, and Summer Time is conservatively valued to be worth well over \$120,000.

Eddie is an expert sailmaker who operates his business at The Boatyard. He loves making sails, especially competitive sails for racing sailboats, but he does not have a strong business sense. The Boatyard makes plenty of money to support the couple's lifestyle, so Eddie doesn't care all that much how much money his sail-making business makes. He is much more interested in the performance of his sails than he is about the profitability of his business. As a result, he clears about \$80,000 per year after expenses in a good year, but barely clears anything in the cyclical years when marina trade income is off.

Since she became sick with her cancer, Brenda has made it a point to train her longtime foreman, Frank, so that he could manage the marina in her place if the need arose. Although she very much wants to maintain family ownership of The Boatyard, Frank has become so valuable that Brenda is now worried that Frank might someday leave her employment for a greener venue. She wonders how it would be best to assure his future services and involvement in the business.

Brenda also inherited her father's home on the water that is adjacent to The Boatyard. Since her father died, Brenda and Eddie have lived in that home as their primary residence and raised their family there. Chuck and Doug really have never known any other place as home. The home is now worth \$1.2 million, but has a basis of only \$600,000 (including the cost of improvements Brenda and Eddie have made in the last several years). Because Brenda is so fiscally conservative, this residence has never had any mortgage encumbrance since she inherited it. Although she considers herself happily married to Eddie, Brenda has consistently honored her father's wishes that their home be titled solely in her name.

Brenda and Eddie's other assets reflect Brenda's conservative nature and the fact that much of these assets were inherited from her father:

Brenda continues to individually own the Farmers National Bank (now BB&T) stock that she inherited from her father 20 years ago. That stock is now worth \$1.5 million and pays dividends of approximately \$45,000 per year.

Brenda and Eddie also have jointly owned bank accounts and CDs worth \$350,000. These accounts and CDs currently pay interest of only about \$3,500 annually.

Brenda owns a whole life policy of life insurance insuring her life with a face value benefit on her death of \$1,000,000. Although the policy is now self-sustaining, it would have a premium of \$15,000 per year were it not now paid up. The policy has a cash value of \$350,000 and a “cost basis” of \$300,000 for premiums paid to date.

The Boatyard Inc. currently has a 401k plan in which Brenda has a vested interest valued at \$900,000.

Eddie has an IRA for which a local bank acts as custodian holding \$250,000 worth of bank CDs.

**Summary of Current Resources**

In summary, Brenda and Eddie’s resources are as follows:

<u>Asset</u>	<u>Value</u>	<u>Basis</u>	<u>Ownership</u>	<u>Annual Income</u>
The Boatyard Inc. S Corp. stock	? (TBD as a part of the exercise)	\$1,000,000	Brenda	\$900,000
Marina land, buildings, piers, and riparian rights	\$4,700,000	\$400,000	Brenda & Eddie as T/E	Included in above
Residence	\$1,200,000	\$600,000		
BB&T stock	\$1,500,000	? (value as of 6/7/1986)	Brenda	\$45,000
Bank accounts	\$350,000	\$350,000	Brenda & Eddie	\$3,500
Life insurance policy insuring Brenda’s life (whole life)	\$1,000,000 face value	\$300,000 (total premiums paid to date)	Brenda	

Brenda's interest in The Boatyard Inc. 401k plan	\$900,000	Brenda
Eddie's IRA account	\$250,000	Eddie

Brenda and Eddie calculate that their personal lifestyle requires a spendable \$150,000 per year after taxes. They need an additional amount for whatever they need to provide Bobby.

### **Estate Planning Goals and Concerns**

Brenda and Eddie come to you looking for help with their estate planning. They want to take care of each other while either is alive, and they want their children ultimately to benefit from shares of equal value. Their special goals and concerns are as follows:

1. **Future Taxation:** They do not like either income taxes or estate taxes and wish to minimize both for themselves and their family in the future.
2. **How do they assure the future operation of The Boatyard at its current location?** They don't want it to be ever sold or moved elsewhere.
3. **Business Succession:** Brenda very much wants to keep The Boatyard "in the family" in the future. Operation by Eddie is inconsistent with her father's wishes and Eddie's inclinations. Neither Andrew nor Chuck have any immediate interest in taking on an administrative role but (at least in Brenda's mind) might in the future. Doug grew up in the marina and might make an ideal candidate to be an operator, but he is "way too young". Brenda would want Doug to have at least five years' experience in the business before taking over. Frank could manage the business in the short term if a means can be found to make sure he will stay.
4. **Bobby:** How best to take care of Bobby and his inheritance in the future. They want to find some way for Bobby to "prove himself" and to accomplish things that will give him a sense of self-worth but are wary of his ability to handle large sums of money.
5. **Chuck and Doug:** They do not believe that their sons should be given any large sums of value to control until they are at least 30 years old.
6. **Charity:** Brenda and Eddie are very charitably inclined. They are deeply interested in environmental concerns dealing with the Chesapeake Bay and annually give at least \$1,000 to the Chesapeake Bay Foundation. They might be willing to increase these annual contributions, and they would also like to start supporting a local mental health organization providing treatment in the local area. As a result of her dealing with breast cancer, Brenda would like to leave meaningful contributions after her death to both the Susan G. Komen Foundation and her local hospital's foundation supporting breast cancer treatment and research. Based on their available resources, Brenda and Eddie would like to see about 10% of their after-death resources devoted to these and other charitable causes, and they would like to see their sons get actively involved in making charitable contributions from their resources both now and in the future.