



2010 Quarterly Client Letter

As you may have heard, the federal estate tax rules changed radically in 2010 and could change radically again in 2011 unless Congress passes new legislation. This letter is intended to advise you of what has happened and encourage you to reevaluate your estate plan as soon as possible.

2001 Tax Act. In 2001, Congress passed the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) which provided for significant phased-in increases in the federal estate, gift and generation skipping tax (GST) exemptions and lower tax rates. EGTRRA provisions included:

- In 2009, the estate and GST exemptions increased to \$3.5 million per decedent, with a flat 45% estate and GST tax rate on any excess. The gift tax exemption was \$1.0 million, with tax rates from 41% to 45%.
- In 2010, the federal estate and GST taxes are repealed for one year. The gift tax \$1.0 million exemption remains, with a lower flat tax rate of 35%. Thus, you have to die or pay gift tax to get the benefit of the change.
- In 2010, the step-up in basis rules (which gave a "fresh-start" fair market basis for most assets of a decedent) is replaced with an adjusted carry-over basis. These new basis rules permit a step-up in basis of up to \$1.3 million, plus an additional \$3.0 million for certain spousal transfers at death.
- On January 1, 2011, EGTRRA will be automatically repealed, resulting in an odd situation: A \$3.5 million estate and GST exemption and flat 45% tax rate in 2009, no estate and GST tax in 2010, and a \$1.0 million estate exemption and tax rate up to 60% in 2011.

Planning in Chaos. Congress's failure to adopt estate tax legislation in 2009 and the possibility that changes will not be adopted during 2010, radically change the estate planning considerations of many clients.

For this year only, instead of an estate tax we have a potential income tax on gain from the sale of assets inherited from a decedent who dies in 2010. Because of the nightmare that this carryover basis rule will cause for 2010, there is a good possibility that sometime this year Congress will pass legislation continuing the estate tax with the old exemption amount (estates worth \$3.5 million would pay no tax) and repealing the one year carry-over basis rule for 2010.

While you probably will not die in 2010, you still need to consider planning for that possibility, because not planning for these changes, if death occurs, can be disastrous. For example:

- Formula clauses (e.g. terms that allocated your estate exemption to a "by-pass trust") in your planning documents could inadvertently disinherit some heirs and/or your surviving spouse and/or create conflicts among family members on how your documents should be properly interpreted.
- Conflicts could arise among your heirs and fiduciaries on asset basis issues.
- Inadvertent generation skipping taxes could be incurred after 2010.
- Passing assets directly to your surviving spouse may result in higher estate taxes after 2010.
- Inadvertent state taxes could be incurred from out of date terms in your documents.

2011 Changes. Unless Congress enacts new legislation in 2010, then on January 1, 2011, some automatic changes occur to the federal tax code, including:

- The estate tax exemption drops to \$1.0 million per decedent.
- The estate tax rate increases (e.g., 55% above \$3.0 million and 60% above \$10 million).
- States which remain "coupled" to the federal estate tax will have their state death taxes restored. Thus, if you own property in one of these coupled states, you could have new exposure to a state estate tax.
- The fair market value step up in basis returns for assets passing from a decedent.

- The top income tax rates go up by at least 4.6%, capital gain tax rates go up by up to 5% and dividend tax rates go up by up to 24.6%.

Uncertainty makes it difficult to plan, but waiting to see what happens next is not a good idea. Please contact your estate attorney at your earliest convenience to avoid paying any unnecessary income and estate taxes. We are also more than happy to contact your estate attorney, on your behalf to determine if you need to take action. . When speaking with attorney's on behalf of our clients, the cost to amend a typical estate plan with a will(s) and revocable by-pass trust(s) is \$250-\$1,000. We will be adding this issue to our annual renewal meeting agenda to assist you in this process.

Please call us if you have any question or comments. Also, if there have been any significant changes in your financial, health or personal situation or a change in your life goals, please contact us to review the possible impact on your financial life planning and wealth management strategy.