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Dear Valued Client:

As you may have heard, the federal estate tax laws changed radically in 2010 and are scheduled to change again in 2011 unless Congress passes new legislation. This letter is intended to advise you of what happened and to address some of your concerns in light of the current situation.

A. Overview of Federal Gift, Estate and GST Taxes.

In 2001, Congress passed the Economic Growth and Tax Relief Reconciliation Act (the “2001 Tax Act”), which provided for significant phased-in increases in the federal gift, estate and generation-skipping transfer (GST) tax exemptions and decreases in the rates of these taxes. The 2001 Tax Act included the following provisions:

- In 2009, the estate and GST tax exemptions increased to \$3.5 million per decedent, with a flat 45% tax rate on any assets in excess of the exemption. The 2009 gift tax exemption was \$1 million, with tax rates ranging from 41% to 45% on gifts in excess of the exemption.
- In 2010, the federal estate and GST taxes were repealed for one year. The \$1 million gift tax exemption remained, with a lower flat tax rate of 35%. The so-called “basis step-up rule,” pursuant to which the cost basis of a decedent’s assets were “stepped up” to the fair market value of those assets on the decedent’s date of death, was replaced with an adjusted carryover basis rule, whereby the decedent’s basis is carried over to his or her beneficiaries. The new basis rule does, however, permit a step-up in basis of the decedent’s assets of up to \$1.3 million, plus an additional \$3 million for certain spousal transfers at death.
- In 2011, the 2001 Tax Act will be automatically repealed, resulting in the reinstatement of the federal estate and GST taxes that were applicable before the 2001 Tax Act, each with a \$1 million exemption and a tax rate of up to 60%. The basis step-up rules will be reinstated. The gift tax exemption will remain at \$1 million, but the tax rates will increase.

B. Expectations Regarding the 2001 Tax Act.

When the 2001 Tax Act was enacted, estate planning practitioners universally believed that Congress would revise the estate tax laws so that the repeal scheduled to take effect in 2010 would never occur. In 2009, practitioners expected Congress to extend the 2009 estate tax laws to apply in 2010. Unexpectedly, however, last December the House failed to act on a one year extension and instead sent the Senate a bill to make the 2009 laws permanent. Because the Senate was focused on

health care and there was broad disagreement in the Senate regarding estate tax issues, Congress did not enact any changes. Thus, effective January 1, 2010, the federal estate and GST taxes were repealed.

C. Possibilities for 2010 and 2011.

With Congress's failure to adopt estate tax legislation in 2009, the current estate tax planning environment is very uncertain. Any number of changes affecting the exemption amounts and tax rates may occur in 2010. Congress might make any new legislation retroactive to January 1, 2010, although there is broad disagreement as to whether a retroactive tax bill would be constitutional. Unless Congress enacts new legislation in 2010, then on January 1, 2011, the following will occur:

- The gift, estate and GST tax exemptions will be \$1 million per decedent.
- The gift, estate and GST tax rates will increase.
- The fair market value step-up in basis rule will return for assets passing from a decedent.

D. The Current Climate.

Clearly these are uncertain times. We do not and cannot know in what direction the law may evolve. Part of the challenge of estate planning is that it involves a number of ever changing factors that are not susceptible to prediction, such as family needs, the value of assets, how assets are titled, federal tax laws, state tax laws, and state laws governing the transfer of property and decision making when it comes to personal and health related matters. It is for this reason that we generally recommend that estate planning documents be reviewed every two to three years, even when there is no turmoil in the federal estate tax arena.

Nonetheless, a few general observations are in order, which, as with all general observations, may or may not apply to your situation, depending upon the terms of your documents and your particular situation. First, it appears that even in the face of the current uncertainty, couples with combined estates that do not exceed \$1 million in value need not be concerned from a federal estate tax standpoint if their estate planning documents do not presently contain tax planning. For other couples with combined estates in excess of \$1 million, it is not possible to make general observations, although couples with so-called "disclaimer plans" are probably positioned most flexibly to deal with the changing tax climate. All clients will want to evaluate their level of risk tolerance given the uncertainty of the federal estate tax environment and determine whether their estate plan warrants further review. Keep in mind that even if an estate plan has been revisited or updated within the last few years, this does not ensure that it properly positions you to minimize taxes and achieve your goals under the current and possible future federal tax laws, as it was universally expected that repeal would never occur.

If you would like to engage us to review your existing plan to determine whether any revisions might be in order to minimize taxes or to achieve other goals, please give us a call.

Sincerely,

Flood, Sheehan & Tobin, PLLC