Tax & Business Consultants

1627 Henthorne Drive • Maumee, Ohio 43537
phone: (419) 866-6000 • fax: (419) 866-6984
e-mail: HTU@toledocpa.com

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Dear Client:

Re: Federal Taxes and Estate Planning

Due to the sweeping changes described below, we are sending this to our clients, former clients, and others.

If you are a client, please call us at your earliest opportunity to schedule a time to go over your current estate plan and determine what changes need to be made to your current plan to minimize taxes and to reduce the possibility of future family conflicts. These are chaotic times as outlined below. Unless we hear that you want to engage us to review your existing plan, we will not begin that process.

We are Estate Tax Free (sort of)! Good News or Not?

For many years, the numbers of families that were affected by the federal estate tax had been dropping because the amount of an estate necessary to file had been increasing from $650,000 to $3,500,000 in 2009. This is why estate planners and your wills and trusts have used terms of art such as "unified credit amount" "taxable amount" or "amount necessary to reduce the estate tax to zero" as measuring tools to determine how much could go to family members without tax. (See description after my signature for more details about this.)

At the Moment - No Federal Estate or Generation Skipping Tax

In an extraordinary and unexpected way, Congress has left us in 2010 with no federal estate or generation skipping tax. This makes it almost impossible to interpret the terms used in wills or trusts and can make the results contrary to what you wished or planned. For example, if your trust states that the amount not subject to federal estate tax goes to your family trust (most of our married clients divide assets at death, between a marital trust and a family trust) and the rest to your spouse, or a marital trust, in 2009 $3.5 million would have gone to a family trust and escaped estate tax and any excess would go to a marital trust of which your spouse was the only current beneficiary, without estate tax. In 2010, with the same estate documents this would lead to the total estate passing to the family trust, with nothing for the marital trust. For some this would be acceptable, (often the spouse is the primary beneficiary of the family trust) for others this would be a disaster. It needs to be determined on a case by case basis based on your wishes and your documents.

In another example, if you left your family the $3.5 million that escaped estate tax and the rest to charity, then the charity would receive nothing, since all of your estate now pays no estate tax. If you left your grandchildren the maximum amount that could go to them without any generation skipping tax, they would now receive the entire estate. It is not hard to see that something that you do not intend could result, or that litigation might be necessary in order to determine what you intended in the absence of an estate tax.

Another Surprise - Carryover Basis (Limited "Step Up" in Basis)

It may seem a wonderful opportunity to have a year without estate tax, but there is also a change in the tax basis of inherited assets that can make your heirs pay more capital gains tax. Under the 2009 rules, there was a step-up in basis when assets were inherited to the value at date of death, limiting any capital gains tax to increases in value after death. Without an estate tax, an heir pays capital gains tax when an asset is sold based upon the decedent's basis (original purchase price in many cases). In 2010, an estate does get to step up $ 1.3 million and potentially another $3 million that go to the surviving spouse. Every executor (person who has control of assets which would include a trustee) must come up with records to support the basis of all assets to make this election, and provide copies to the IRS as well as to each heir. Of course, it is difficult for anyone to locate records of purchase, improvements, depreciation, etc. for each investment or piece of real estate.

Generation Skipping Tax in 2011

Generation Skipping Tax planning is uncertain for the future. For 2011 we are to pretend that the 2010 lack of Generation Skipping Tax did not exist. This creates all sorts of interesting questions with no answers. For those who like uncertainty and want to assume it will work in their favor, this is an opportunity. For the rest, this is a time to review any such planning and perhaps defer making gifts to grandchildren and others affected by this tax (typically persons more than 37.5 years younger than the donor).

We Are Not Done Yet- In 2011 the Law Rolls Back to 2001

If nothing changes, the estate tax comes back in 2011, for all estates over one million dollars and step-up basis returns. Congress could also decide to retroactively apply an estate tax in 20 I0, and no one knows if it will be retroactive to the beginning of the year. President Obama has made such a proposal.

Some of my clients may have beneficiary designations which rely on tax terms than are presently meaningless (for example, references to assets qualifying for the marital trust). These terms may have also been used in prenuptial agreements and even buy-sell agreements.

Our Advice

We urge you to meet with us to review your current estate planning documents and family situation. We anticipate a meeting lasting no more than 2 hours, but you will have the peace of mind of understanding what would happen using your current plan in 2010 or 2011 and you can decide if making a change is necessary, or not. This could be a telephone meeting where we review your documents in advance. We will also explain what sort of records should be gathered and kept for carryover basis and the executor's election. We can amend your estate planning documents to provide your fiduciary with the power to make the necessary election. **While there is still a gift tax** with a million dollar exemption amount, the current gift tax rate (35%) is lower than it will be in 2011 (45%) should you wish to make taxable gifts.

While we highly recommend that you review your estate planning documents every three years or when there is a family event change, the 2010 changes in the law make this review essential. If we did meet with you in the last year and reviewed your documents we did discuss the above changes.

Please call my office at your earliest convenience to schedule a meeting to discuss these changes.

Sincerely,

HANTZ TITUS URBANSKI, LLC.
Tax and Business Consultants

For those of you who would like a more technical explanation, please keep reading:

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 were repealed for one year. The gift tax $1.0 million exemption remained, with a lower flat tax rate of 35%. Thus, you had to die or pay gift tax to get the benefit of the change. The step up in basis rules (which gave a "fresh-start" fair market basis for most assets of a decedent) was 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 was 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.

What Happened in 2009? Estate planning practitioners universally expected Congress to carry the 2009 estate tax rules across 2010 (both Representative Rangel as Chair of the House Ways and Means and Senator Baucus as Chair of the Senate Finance Committee said it would happen earlier last fall, as did many others). However, unexpectedly in December the House failed to act on a one year extension and instead sent the Senate a bill to make the 2009 rules permanent. Because the Senate was focused on health care and there was broad disagreement in the Senate on what to do with estate taxes, Congress enacted no changes to the EGTRRA's 2010 rules. Thus, effective as of January 1, 2010

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 plaI1I1ing considerations of many clients. For example, Congress has indicated that in 2010 about 6,000 decedents will benefit from the elimination of estate taxes, but over 70,000 heirs will pay higher income taxes because of the change in the income tax basis rules for assets received from decedents.

2010 Changes. The U.S. has an unpredictable planning environment in which any number of radically different changes may occur in 2010:

- Congress may do nothing in 2010, in which case there is an adjusted carryover basis, and no federal estate or generation skipping tax for people who die in 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 "bypass 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 (non-Michigan at this time) could be incurred from out of date terms in your documents.

- Congress may adopt legislation to carry the 2009 rules over 2010, retroactive to January 1, 2010. (This was recently proposed by President Obama.) There is broad disagreement on whether a retroactive tax bill is constitutional. If a retroactive law it adopted, it will be challenged as unconstitutional and it could take years for the Supreme Court to rule on the issue (similar disputes in the past took seven to ten years to be determined by the Supreme Court). Until such a ruling, uncertainty will prevail. Those dying after the enactment should not have that uncertainty. In any event, your estate plan should contemplate dying both before or after a potential retroactive enactment, which may or may not be constitutional.

- If Congress acts in 2010 to address the estate tax issues, it could:
  - Adopt permanent estate tax exemption, beginning in 2010 or 2011. If so, most commentators anticipate estate tax exemptions to fall between $2-5.0 million and tax rates 35% to 45%.
  - Adopt a temporary higher estate exemption.
  - Adopt rules to limit or eliminate valuation discounts.

2011 Changes Unless Congress enacts new legislation in 2010, then on January 1, 2011, a number of 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 (This is the case in Michigan). Thus, if you own property in one of these coupled states, you could have new exposure to a state estate tax. (This is complicated, and if you are a Michigan resident with only Michigan property, this is one of the least of your concerns.)
- 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%.

Effectively, unless Congress adopts new legislation, in 2010 the estate tax rules rotate 180 degrees from where they were in 2009, and then rotate 180 degrees again in 2011 - only the estate tax and income tax rules could be even worse than what we had in 2009. Uncertainty makes it difficult to plan, but waiting to see what happens next is not a good idea. The earlier you can implement flexible tax and estate planning to respond to these changes, the better.

Again, please call us to schedule a time to go over your current estate plan and determine what changes need to be made to your current plan to minimize taxes and to reduce the possibility of future family conflicts in these chaotic times. Again, unless we hear that you want to engage us to review your existing plan, we will not begin that process.