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January 21, 2010

TO OUR ESTATE PLANNING CLIENTS

As of the date of this memorandum, the tax, distribution and other consequences for some decedents who die during 2010 may be uncertain.

The law as currently written provides that with limited exceptions involving non-US citizens, there is no federal estate tax for decedents dying during calendar year 2010. The estate tax is scheduled to return in 2011 with an exemption of only $1,000,000. The effect of this situation on many documents which we have drafted is that, generally, the actual estate planning objectives of most clients will still be achieved, although more assets than desirable may end up in trust for the benefit of the surviving spouse. Assets passing by beneficiary designation to a surviving spouse or by operation of law to a surviving spouse as a result of joint ownership will not be affected by these changes in the federal estate tax.

For clients residing in Delaware, if the estate of either spouse exceeds $3.5 million, many of our documents may have the effect of causing a *Delaware* estate tax to be due when the first spouse dies. We would not necessarily recommend changing these documents since the long-term tax consequences of paying the *Delaware* estate tax upfront may be very favorable. If the federal estate tax is not retroactively reenacted but is prospectively reenacted, or simply remains in place for decedents dying in 2010 or later, there will be savings in federal estate tax at the surviving spouse's death which will be far greater than any Delaware estate tax paid at the first spouse's death. Our concern about the Delaware estate tax would also apply for different but related reasons to any clients who reside in New Jersey. This concern does not apply to our clients who reside in Pennsylvania and Florida, but could apply to certain clients who reside in Maryland.

The lapse of the federal estate tax will also have an adverse effect on the "basis" of inherited property. Under federal law as it existed until 2009, assets includible in an estate of a decedent (other than individual retirement accounts, qualified pension and profit sharing plans, and certain other special assets) received a new basis equal to fair market value on the date of

death. Under the law as in effect for 2010, if Congress does nothing, heirs will use the basis of the property in the hands of the decedent (or its fair market value on the decedent's date of death, if lower), but will be able to step up the basis in the amount of $1.3 million which may be allocated among various assets. Assets passing to the surviving spouse outright or in certain types of trusts receive up to a $3 million basis increase. The consequence of the new basis rules if Congress does nothing for 2010 is that the income tax effect on sales of inherited assets and the amount of depreciation which may be taken on inherited assets is uncertain.

The generation skipping transfer tax, which applies to direct transfers and certain transfers in trust to grandchildren and more remote descendants is also no longer in effect during 2010. So long as the 2010 system remains in effect and the generation skipping tax is not retroactively enacted, there will be no generation skipping tax applicable to this type of transfer.

The law in effect before 2010 provided for a $3,500,000 exemption which could be applied against generation skipping transfers. Because of the many different fashions in which clients may have made use of the generation exemptions, it is difficult to give general advice concerning how the repeal of the generation skipping tax may affect a particular estate plan. We suggest that clients whose estate plans make extensive use of generation skipping planning contact us for specific advice on how their documents handle the current state of the law.

The gift tax remains in effect, with a $1,000,000 lifetime exemption and $13,000 per donee annual exclusion. The gift tax rate for the time being is 35% on gifts not covered by these exemptions.

As a result of the uncertainty as to the immediate future of the law, we suggest that the following clients contact us for advice specifically tailored to their own situations:

1. All married clients residing in Delaware if the assets of either or both spouses, individually, exceed $3,500,000.

2. All married clients, regardless of the state of residence, if the residuary portion of the estate plan consists of something other than a trust for the benefit of the surviving spouse.

3. All married clients residing in New Jersey.

4. All clients whose estate plans make extensive use of generation skipping transfers.

5. All clients who have substantial charitable gifts in their estate plans, especially if the gifts to charities are expressed in terms of a formula rather than a specific dollar amount.

Any client who does not fall into one of the above groups, but has specific questions concerning how his or her estate plan may be affected by the current uncertainty in the

law, should not hesitate to contact us. While we recognize that many of the recipients of this letter may not be required to make any changes to their estate planning documents, we want to make certain that as many estate planning clients as possible are made aware of this situation.

If you have any questions, please do not hesitate to call to discuss these matters.

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