

November 25, 2003

**ESTATE PLANNING ALERT**

You have, no doubt, been hearing about the recent changes in the estate tax and gift tax laws, and have wondered how these changes will affect your planning and your family. On June 7, 2001, President Bush signed the Economic Growth and Tax Relief Reconciliation Act of 2001 (the “2001 Tax Act”). We are carefully watching developments, and will keep our clients advised of any future legislative changes and what would be appropriate in different situations. Although an environment of substantial uncertainty surrounds the current law (especially since all of the provisions of the 2001 Tax Act sunset effective January 1, 2011), we thought you might be interested in a few observations and comments:

1. The 2001 Tax Act has the following primary features that would impact most of our clients:
  - *Phase-In and Elimination of Tax.* The changes are all formulated as “phase-in” provisions. Under the current phase-in schedule, the estate tax applicable exclusion amount for an individual is \$1.5 million for two years (2004-2005), \$2.0 million for three years (2006-2008), and \$3.5 million for one year (2009). The estate tax would then be repealed in 2010 (but for only one year under the sunset provision of the law). In 2011, the estate tax applicable exclusion amount would presumably drop back to \$1.0 million, as the law would then revert back to its pre-2001 Tax Act state.
  - *Phase-In Reduction of Rates.* The Maximum Tax Rate is reduced to 48 percent by the year 2004. The Maximum Tax Rate is further reduced by 1 percentage point per year until it becomes 45 percent in 2007.
  - *Loss of Step Up in Basis.* As you probably know, there is an adjustment in the income tax “basis” on property owned by a person at the date of death. This is an adjustment to make the new basis in the hands of the heirs equal to the value of the asset at the date of death. Essentially, this results in the elimination of capital gains up through the date of death. Under the current law, however, the **general** rule is that the stepped-up basis is not allowed for a decedent dying after December 31, 2009, and the basis of property acquired from such decedent is the lesser of the decedent’s adjusted basis or the fair market value of the property on the decedent’s death. (Please note that a \$1.3 million basis adjustment will be allowed, and a \$3.0 million separate basis adjustment will be allowed for transfers to surviving spouses or the QTIP trusts.)
2. What should you do now? Answer: try not to die any time soon. Seriously, since all of these changes involve gradual phase-in features, it is important to recognize that untimely death will result in the same tax exposure that exists under current law. For that reason (and because the law’s sunset provisions virtually assure that there will be future legislative changes), you should not make any changes in your tax planning at this time. As stated above, we will be monitoring future changes and will be in contact with you as changes occur.

3. Thoughts to keep in mind:

- Although much of your motivation for action may have been related to tax savings, we are sure that you discovered in the process that there are many “people issues” involved in your planning. Such matters as determining the circumstances that best suit your children for receiving a possible inheritance, protection from creditors’ claims, and other practical features of the plan that you have in place, may mean that despite any tax law changes, you may not want to make any dramatic change in your planning, even if the tax is ultimately abolished.
- The possibility of a “tax-free” environment will create many exciting opportunities for long-term planning. This may clear the way for much more effective and meaningful methods to allow you to protect your family assets from potential creditors’ claims, and to arrange for the long-term disposition of your assets in ways that were not possible with the restrictions caused by the current tax structure. We would also assume that many people would be interested in taking advantage of the opportunity to arrange the family assets to avoid exposure to potential tax.
- The potential problems and concerns related to loss of the “step up” in basis will also require planning in order to avoid unnecessary tax, and take advantage of any planning opportunities.

**IN SUMMARY, we will be carefully watching developments, and will make every effort to keep our clients advised of developments as soon as they occur, and will be working to anticipate changes so that we can promptly respond to your needs. As always, we are available to answer any questions that you may have. Please feel free to call on us if you have any questions.**