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To Our Clients:

January 2010

Since the estate tax has received quite a bit of attention recently, we thought you might welcome an update to help you track the changes which have occurred and decide whether your estate plan needs attention and/or you want more detailed information about gifting opportunities.

Federal Tax Law Changes

In 2001 Congress established the federal estate tax, generation-skipping tax and gift tax exemption amounts and tax rates for the following ten years, including the repeal of the estate tax in its entirety for the year 2010. Despite Congressional efforts at the end of 2009 to prevent repeal, there is no federal estate tax today and no federal generation-skipping transfer tax either. The federal gift tax remains in place with a \$1,000,000 lifetime exemption but at a lower rate (35%) than in 2009 when the gift tax rate was 45%. The \$13,000 annual-per-donee exclusion is still available.

With the elimination of the federal estate tax for 2010 comes something new called carry-over basis. Prior to 2010, when property was inherited from an estate, the recipient received a new income tax basis in the property equal to its value on the decedent's date of death. This meant property sold soon after being inherited generally did not trigger a substantial capital gains tax. This "step up in basis" system has been eliminated in 2010. A capital gains tax on unrealized gain carried over from a decedent will be imposed when inherited property is sold. Exemptions are provided to eliminate \$1,300,000 in gains on property passing to anyone and an additional \$3,000,000 in gains on property passing to a spouse or certain trusts for the benefit of a spouse.

If Congress again fails to deal with the estate tax in 2010, the program enacted in 2001 will "sunset" on January 1, 2011, and the federal estate, generation-skipping and gift taxes will be reinstated at the 2001 exemption amounts and rates (a \$1,000,000 unified exemption from federal estate tax and gift tax and a top tax rate of 55%; for larger estates, part can be taxed at 60%). Although Democratic Senate leaders have said that they will seek to extend retroactively the 2009 estate tax law (with a \$3,500,000 exemption and a 45% rate), it is uncertain whether Congress will act in 2010 and, if so, whether such an extension would be retroactive to the beginning of the year.

Connecticut Tax Law Changes

The Connecticut estate tax law and the federal estate tax law have been "decoupled" for several years, which means they are completely separate and operate independently of one another.

Connecticut passed legislation in September 2009 to increase the state's estate tax exemption amount from \$2,000,000 to \$3,500,000, increase the state's gift tax exemption amount to \$3,500,000, and reduce the marginal rates on estates and gifts in excess of these exemption amounts to 12%. On December 21, 2009, the Connecticut legislature voted to postpone the effective date of the new law until January 1, 2012 and increase the rates, but on December 28, 2009 Governor Rell vetoed that measure. Consequently, the new Connecticut estate and gift tax law is now in effect and will remain so absent a vote by the legislature to override the Governor's veto.

Should You Change Your Estate Plan?

Changes to your estate plan may be advisable if you are concerned that you may not survive the reinstatement of the federal estate tax (either by legislation in 2010 or by current law on January 1, 2011). If you would prefer to avoid legal expense that may prove to be unnecessary, you may wish to wait until the current chaos concerning the estate, gift and generation-skipping transfer taxes is resolved. We recommend that you review the following information regarding the need to revise your estate plan in order to decide whether you should be proactive by calling us now rather than waiting.

1. Credit/Marital Formula Clauses. Many of our married clients have estate planning documents that divide the residuary estate of the first spouse to die by a tax formula clause between the largest share that may pass free of estate tax (typically called either the "unified credit share" or the "estate tax sheltered share") and the balance of the residuary estate (the "marital share"). Often, the unified credit share is left to a trust in which the surviving spouse is the primary beneficiary and the marital share either passes outright to the surviving spouse or to a Marital Trust for the sole benefit of the surviving spouse. Some commentators have raised the possibility that a formula division is meaningless if there is no federal estate tax at the client's death, in which case it may not be absolutely certain whether the formula tax clause will be interpreted as passing the entire residuary estate to the unified credit share or the marital share. This raises two potential concerns: (1) if the entire estate is determined to be the unified credit share and that share passes to individuals or trusts which you did not want to receive your entire estate, you may prejudice or disinherit your spouse if you die this year; and (2) if the entire estate is determined to be the marital share, your estate plan may not have the flexibility to maximize shelter from future taxes. While it is not clear that either of these scenarios is a likely result, you may not want to take the risk that the commentators may be correct.

2. GST Exemption Formulas. Many clients have an estate plan that divides their assets between the share that is exempt from generation-skipping transfer tax ("GST Tax") and typically passes to "Lifetime Trusts" for their descendants and the share that is not exempt from GST Tax and passes outright to their descendants at some point. If a client with such a plan dies before the federal generation-skipping transfer tax is reenacted, we cannot be absolutely certain whether all of their assets will be allocated to the share passing to the Lifetime Trusts or to the outright share.

3. Charitable Deduction Formulas. Some estate plans provide for assets to be divided between individual beneficiaries and charities based on a formula tax clause and the amount passing to individuals is not capped at a fixed amount. It is not clear how such formulas and caps will be interpreted when no federal estate tax exists.

4. Carryover Basis. If you die in 2010 and the federal estate tax does not apply to your estate, your appreciated assets will not receive a step-up in basis at death which may increase the capital gains taxes payable upon sale. If you are married and you or your spouse dies before reenactment of the estate tax, the deceased spouse has more than \$1,300,000 of unrealized capital gains in assets in his or her sole name and the estate plan does not result in the surviving spouse, or a qualifying trust for the surviving spouse, receiving assets with \$3,000,000 or more of unrealized gains, it may be that capital gains tax could have been reduced by changing the plan before death.

5. Determining the Need to Contact Us Now. **We recommend that you contact your Cummings & Lockwood attorney if:**

a. **You have reason to believe there is a significant possibility that you may not survive until January 1, 2011 or the earlier reinstatement of the federal estate tax.**

b. **You are married and your estate plan leaves the unified credit share to beneficiaries other than to a trust with the surviving spouse as the primary beneficiary or otherwise in a manner you do not desire.**

c. **Your estate plan divides your estate between individual beneficiaries and charities based on a formula and the amount passing to individual beneficiaries is not capped at a fixed amount.**

d. **You are concerned about the ambiguities discussed in this letter and would rather incur the expense of revising your documents now to make certain the result is clear in case you die before the federal estate tax is reinstated rather than assume you will survive until that time.**

6. Preparation. Before calling, we suggest that you prepare and provide your attorney with a net worth statement listing the value of your assets (including your IRAs or other retirement accounts) with enough detail to show the total current value and approximate cost basis of the assets in your name, the assets in your spouse's name if you are married, and in joint name with right of survivorship.

Potential Gifting Opportunities Under Current Law

Many clients have considered making lifetime gifts in excess of their lifetime exemptions and paying a current gift tax in order to reduce estate taxes. For those who are willing to pay gift tax on large gifts that are not covered by the remaining gift tax exemption, making such gifts soon after January 1 might be attractive. Although the gift tax remains in place in 2010, the rate of tax on gifts is lower than it has been in a decade. The 2010 gift tax rate is 35%, as compared to a 45% rate in 2009 and a 55% maximum rate scheduled for 2011 and beyond.

The GST Tax does not exist in 2010. Arguably, transfers made to your descendants, or to trusts for their benefit, can be made in 2010 without any GST Tax being imposed or any GST exemption being used to shelter gifts from the GST Tax. This makes early 2010 an attractive time to make gifts that are intended to benefit multiple generations.

There is, of course, the risk that any tax law changes made in 2010 will be retroactive, thus imposing unintended gift tax and GST Tax consequences on 2010 gifts. For that reason, you may want to consult with your Cummings & Lockwood attorney regarding techniques, such as GRATs and Lifetime Marital or "QTIP" Trusts," which can be designed flexibly to either become GST vehicles or not, depending on how the GST Tax law ultimately develops in 2010 and beyond. The advantages of these techniques are reviewed in detail in our client memorandum entitled "Estate Planning Opportunities in 2010," which will be available in the very near future on our website (www.cl-law.com).

Closing Thoughts: "That's another fine mess you've gotten us into."

Oliver Hardy said this to Stan Laurel many times during their entertainment careers. As 2010 unfolds and the complexity of the current state of our affairs is appreciated by more people, we expect politicians on both sides of the aisle on both the federal and state levels will be replaying the Laurel and Hardy act. 2010 will prove to be a challenging year for estate and gift planning but also will provide opportunities for some clients to use the uncertainty and fluctuation to their advantage.

We will continue to keep you apprised of new developments in the law and effective gifting and planning strategies throughout the year via advisories posted on our website (www.cl-law.com), e-mail alerts and, when warranted, mailings. Please either advise us of or confirm your preferred e-mail address for future e-mail alerts by either completing and detaching the slip that appears below and mailing it to your Cummings & Lockwood attorney or by e-mailing your Cummings & Lockwood attorney directly with the information. If married and both spouses would like to receive the e-mail alerts, please let us know this when providing us your email information.

Name(s): _____

Preferred E-Mail Address(es): _____

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In this Update, we have deliberately simplified technical aspects of the law in the interest of clear communication. Under no circumstances should you or your advisors rely solely on the contents of this Update for legal advice, nor should you reach any decisions with respect to your personal tax or estate planning without further discussion and consultation with your advisors.

In accordance with IRS Circular 230, we are required to disclose that: (i) this Update is not intended or written by us to be used, and it cannot be used by any taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer; (ii) this Update was written to support the promotion or marketing of the transaction(s) or matter(s) addressed by such materials; and (iii) each taxpayer should seek advice on his or her particular circumstances from an independent tax advisor.