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AN IMPORTANT MESSAGE ABOUT THE 2010 TAX RELIEF ACT

Dear Clients and their Professional Advisers:

As you probably know by now, major changes to the federal estate tax laws passed late December as part of “The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (2010 Tax Act).” While there was much talk and media coverage about 2010 year end planning, we’re now in 2011 and new and valuable opportunities for estate planning abound.

Contrary to media reports, estate planning is not only for the ultra-high net worth family. Estate planning remains a vital endeavor for anyone seeking to protect their loved ones, safeguard their assets, address a wide range of religious and health related issues, and yes, to minimize taxes. While a holistic approach to planning, addressing whatever diverse goals and objectives you have, is the ideal, there are a host of new tax related planning issues that many taxpayers need to address in light of the 2010 Tax Act. Some of these are listed below to help alert you to the broad and continuing implications of the 2010 Tax Act.

In light of enactment of the 2010 Tax Act, we suggest that you review your existing estate plans and documents to ensure that they continue to reflect your objectives. Here are a few general ideas and comments of the many areas you should consider, and which we can help you evaluate to determine which, if any, might apply to you:

1. *Higher but Temporary Increases in Exemptions:* The gift, estate and generation skipping transfer (GST) exemptions are \$5 million for 2011 through 2012. The gift, estate and GST tax rates have been reduced to 35% for 2011 and 2012. This does not mean that those with under \$5 million in assets can ignore planning. One of the principal reasons is that the exemptions and rates after 2012 are scheduled to change back to their pre-2001 levels of \$1 million and 55% (although the GST exemption will have been adjusted for inflation). Also, if you die residing in or owning property in one of the many states that has an independent estate or inheritance tax system, the exemption thresholds will be much lower. In any case, it seems that 2011 and 2012 may provide the best opportunity to shift wealth in the history of the estate tax.

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2. *2013 Law:* Don't forget these generous changes are still only temporary. They end after 2012. As mentioned above, beginning in 2013, a \$1 million exemption and 55% rate return, unless Congress acts. We can guide you in planning for this continued estate roller coaster.
3. *Large Current Gifts:* Should you make large gifts now? These may lock in valuation discounts which are still permitted under current law, but may again be proposed for legislative restriction or repeal in the future. Significant current gifts can remove future appreciation from your estate. However, under the law as it is currently written, at least some of the benefits of lifetime gifts may well be recaptured when you die if your estate is subject to estate tax.
4. *Simplifying or Unwinding Prior Planning:* Planning for some clients will be simpler and less costly. We can help you evaluate what, if anything, can be done with existing irrevocable trusts, insurance plans, and so forth. Many existing planning vehicles may be reapplied in new ways to accomplish important current goals even if your tax goals have changed. These might include: income tax planning, asset protection, management, and more. If some of your existing trusts or entities can be simplified, or even eliminated, there could be annual savings in tax preparation, management and other costs. We can help you determine which, if any, steps are advisable.
5. *Review Your Will and, If You Use One, Your Revocable Trust:* Your existing estate planning documents should be reviewed now that the law is clear to determine what revisions are necessary. The formulas used to govern distributions and bequests under your documents may need to be updated to reflect the new law and other changes. The tax allocation clause should be reviewed in light of the new law, potential large lifetime gift transfers you might make, and other developments.
6. *Portability:* Under the new law, you can, in effect, bequeath your estate tax exemption to your spouse. This appears to mean that your will or revocable trust can simply provide for your spouse to inherit all your wealth directly or in one trust without losing the benefit of using your estate tax exemption. However, we can explain why this provision has sufficient shortcomings and traps that it generally should not be relied upon as a first line of defense in the estate plan for a married person.
7. *Review Your Power of Attorney:* Your powers of attorney may have been written with different tax and legal objectives than now apply to your situation. Should you revise the gift provisions in your powers of attorney? Depending on your situation these rights might warrant expanding considerably, restricting, or

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eliminating. We can help you decide which measures are appropriate and how to tailor provisions to meet your personal needs.

8. *Life Insurance:* How does your existing insurance coverage fit your current needs and the current and possible future law? Perhaps you might wish to lower coverage to save cost if you are confident that the full coverage is unnecessary because the estate and GST exemptions have been substantially increased. However, as mentioned above, the full estate and GST tax regimes return after 2012. Therefore, while it may be appropriate to consider the level of life insurance coverage and the manner in which it is owned and administered, the temporary lifting of the exemptions and lowering of rates suggest that action be taken only after very careful consideration.
9. *Business Succession Planning:* Regardless of the degree to which your estate may be exposed to estate taxes, it is always appropriate to plan carefully with respect to the disposition of business interests that comprise a significant part of your wealth, especially if you run the company. One factor to explore is how any so-called "buy sell" agreement may be affected by new more generous income tax deductions for equipment and furniture purchases.
10. *Roth Conversions:* The much talked about conversion of an IRA to a Roth IRA might warrant evaluation in light of the 2010 Tax Act. One of the motivating factors to convert an IRA (to "Roth-it") was that the income tax paid would be removed from the taxpayer's estate thereby reducing his or her estate tax.
11. *Matrimonial Considerations:* Prenuptial agreements should be reviewed to ascertain if they have used formula clauses, or have provisions based on estate tax assumptions, that are no longer valid. If someone in your family is planning to marry, a prenuptial agreements might warrant addressing issues concerning the portability of each new spouse's estate tax basic exemption amount.
12. *State Estate Tax:* What steps might you wish to take to address state estate tax considerations? While Virginia has no estate tax at present, if you have assets in other states, you may have a potential state estate tax issue. If your estate falls well below the \$5 million federal estate tax exemption, you may still face significant state estate taxes in those states. If so, it seems worthwhile to seek professional guidance as to such matters.

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Estate planning was never just about estate taxes. We have always helped our clients evaluate retirement planning, gift planning, business succession planning, and a wide range of other issues. Let us help you address these dramatic changes in the law in the same comprehensive manner.

Very truly yours,

Freed & Shepherd, P.C.

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