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MEMORANDUM

FROM: White & Allen, P.A.

TO: Clients and Friends of the Firm

DATE: April 15, 2010

RE: The Economic Growth and Tax Relief Reconciliation Act of 2001

Who would have thought it? We all assumed that the estate tax and generation skipping tax would not go away. We all assumed that Congress would act prior to January 1, 2010 to preclude the repeal of those taxes. Even late last year and early this year, we all thought that Congress would, at a minimum, "kick the can down the road" for one year. At a minimum, we thought Congress would pass a resolution to make the 2009 tax law apply in 2010. We were all wrong. As we sit here on April 15, 2010, we are in uncharted territory.

Where are we? One of the Bush initiatives was the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"). EGTRRA brought about a number of changes to the transfer tax system. EGTRRA repealed the federal death tax effective for estates of decedents dying after December 31, 2009. EGTRRA repealed the federal generation skipping tax effective for estates of decedents dying after December 31, 2009. EGTRRA also repealed the five percent surtax for estates of decedents dying, and gifts made, after December 31, 2001. EGTRRA eliminated the step-up in basis to fair market value for a decedent's property at death. EGTRRA contained carry-over basis rules for a decedent's property. EGTRRA made certain other changes to the transfer tax system. However, all of EGTRRA's provisions were temporary unless they were extended by Congress in the future. That is, all tax changes made by EGTRRA expire, or "sunset" on December 31, 2010. So here we are. The estate and generation skipping taxes have been repealed for

the 2010 calendar year, while the gift tax remains in place. For the 2010 calendar year, the gift tax exemption is $1,000,000.00 and the maximum gift tax rate has been reduced from 45% to 35%. We also have a "modified carry-over basis" regime and the step-up in basis rule with respect to a decedent's property is repealed. The estate tax, gift tax, and generation skipping tax, as they existed before 2002, will all be reinstated January 1, 2011. This will mean a maximum transfer tax rate of 55%, with a 5% surcharge on estates or cumulative gifts between $10,000,000.00 and $17,184,000.00. The estate and gift tax exemptions were $675,000.00 in 2001. However, with the sunset of EGTRRA, the estate and gift tax exemptions would revert to $1,000,000.00, which they were already scheduled to increase to. The generation skipping tax exemption would revert to $1,000,000.00, but adjusted for inflation since 1999. It is estimated that the inflation adjusted generation skipping tax exemption would be approximately $1,340,000.00.

How did we get here? Everyone assumed that Congress would not let the death tax and generation skipping tax go away. In fact, on December 2, 2009, the House of Representatives passed a bill making the transfer tax law which was effective in 2009, permanent. When the bill reached the Senate, the Senators were in the midst of the health care debate. Finance Committee Chairman Max Baucus asked the Senate for unanimous consent to bring the bill to the floor, and approve an amendment to extend the 2009 law for two months. The Republican leadership wanted an amendment calling for a unified $5,000,000.00 exemption which was portable, and a 35% maximum transfer tax rate. This was not acceptable to the Democrats and the matter died.

What will Congress do? Who knows. It is impossible to know what Congress will do. If they do act in 2010, it is impossible to know what the effective date of the legislation will be. One question that has arisen is whether or not Congress could act in 2010 and make the law retroactive to January 1. There is authority for making the tax law change effective retroactively. United States vs. Carlton, 512 U.S. 26 (1994). In Carlton, the Court held that a retroactive amendment to the tax law was permissible if it was justified by a legitimate legislative purpose and was not excessive in length. Five of the justices who decided Carlton are still on the Court. Of course, Congress could just do nothing and let the provisions of EGTRRA sunset December 31, 2010. One thing is clear, what we have now is a "big mess". One commentator has aptly described our current situation as being the result of "congressional malpractice".

What are the implications? Testamentary documents tied to tax formulas and estate plans motivated by transfer taxes are obviously impacted. Existing documents that provide for apportionment of the decedent's estate between a credit shelter share (for the children) and a marital deduction share (for the spouse) are problematic. The possible results are uncertain, depending upon the exact wording of the apportionment provision. Consider the following, in light of the current repeal:

* "I leave the maximum amount that can pass free from federal estate tax to my children, and the balance to my spouse." Who gets what? As there is no estate tax, we could conclude that the entire estate passes to the children, and nothing passes to the spouse.

* "I leave the minimum amount necessary to reduce the federal estate tax to zero to my spouse, and the balance to my children." Who gets what? As there is no estate tax, we could conclude that nothing passes to the spouse, and the entire estate passes to the children.

* "I leave the maximum amount that can pass free from federal estate tax, by virtue of the applicable exclusion amount of the unified credit, to my children, and the balance to my spouse." Who gets what? As there is no applicable exclusion amount of the unified credit, we could conclude that nothing passes to the children, and the entire estate passes to the spouse.

Similar questions are raised with respect to dispositions tied to the generation skipping tax exemption. With the repeal of the generation skipping tax, do we now make substantial generation skipping gifts in 2010? If generation skipping transfers are made outright or from existing trusts, there would appear to be no generation skipping tax implications, as long as the law is not changed retroactively. If generation skipping transfers are made into trusts in 2010, when the generation skipping tax exemption and the deemed allocation rules do not exist, and EGTRRA sunsets December 31, 2010, what are the tax consequences of subsequent generation skipping transfers out of those trusts? Should we all be planning for the modified carry-over basis regime? It is easy to see that there are more questions than there are answers. One thing is for sure, the sooner that Congress acts and these issues are resolved, the better for all.

Conclusion. We thought that Congress would have acted in 2009 or early in 2010 to deal with these issues. That is one reason why we have not communicated with you sooner. Given the gridlock in Congress, and the fact that we are now four months into the calendar year, there is a real possibility that there will be no legislative remedy this year. The transfer tax repeal for the 2010 calendar year may or may not create a problem for a given client. Potential problems caused by the repeal are as numerous as there are clients, and there is no standard solution for all problems. We can draw some general conclusions. There are many clients who would not have a transfer tax problem with a $1,000,000.00 exemption, and certainly would not have a transfer tax problem where the exemption increased to its 2009 amount of $3,500,000.00. Many of those clients have simple straight forward Wills that leave everything to the surviving spouse, and at the death of the last of the spouses to die, on to the children. These clients, and these

types of testamentary documents, are probably unaffected by the repeal. Testamentary documents that have extensive transfer tax planning provisions, may well be impacted by the repeal. A main fear is that because of the exact wording of the testamentary document, the surviving spouse could be effectively "cut out", with the entire estate passing to children or other beneficiaries. If there is a problem regarding the specific wording of a testamentary document, a brief codicil may be all that is required to "fix" the situation. In other cases, a more extensive redraft may be in order. If EGTRRA sunsets, with a resulting $1,000,000.00 exemption in 2011, many couples who did not have a death tax problem at a $3,500,000.00 exemption, may find themselves over the $1,000,000.00 exemption limit. In short, there is no "one size fits all" answer. We will be glad to review your testamentary documents to determine how they are impacted by the repeal. If we can be of assistance in this regard, please contact us.