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Insight

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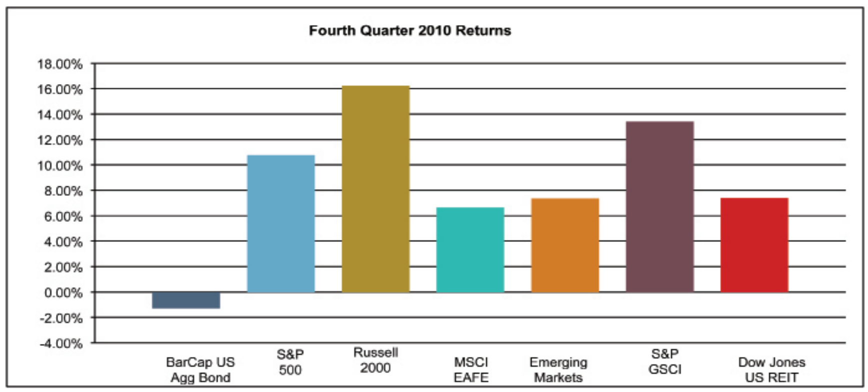
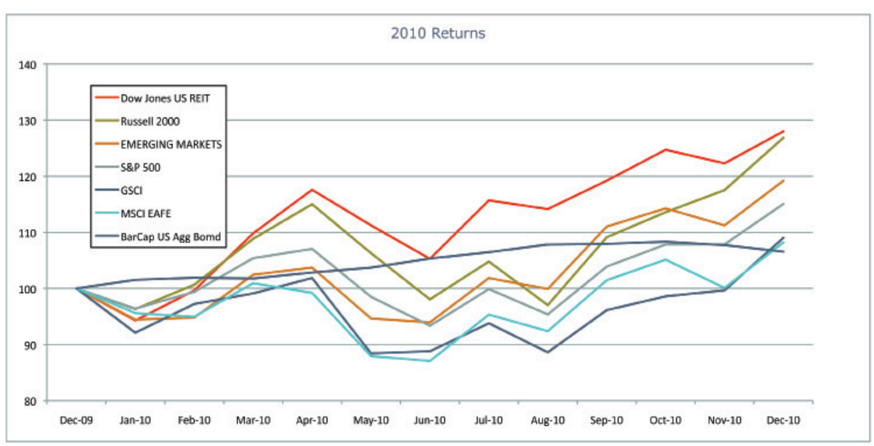
A Strong Finish to 2010

The fourth quarter of 2010 produced very strong returns for all equity asset classes, with big rallies in December, as good holiday sales and an improving jobs environment spurred increased consumer and investor confidence.



Small cap stocks (domestic and overseas), emerging markets, and US and overseas REITS outperformed global large cap stocks. Aspiriant's clients are very broadly exposed to these opportunities and despite relative weakness in developed overseas large cap stocks (up about 8% for 2010, as a whole, compared to the 15% gain for the S&P 500) and with fixed income returns generally, at about the 6% level, almost all client portfolios enjoyed gains **well** above 10% for the year.



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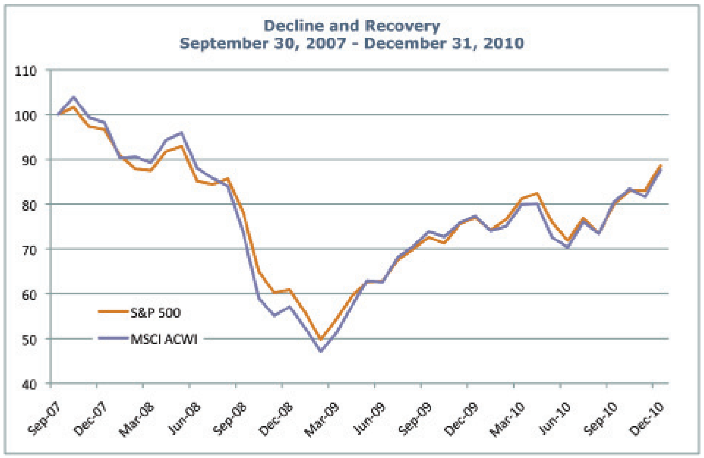
Despite this portfolio performance, on top of the very strong initial recovery in the last quarters of 2009, the psychic wounds of the severe global financial crisis of 2008 are still not completely healed. Measuring the S&P 500 and the All Country World Index (ACWI) since the market highs of late 2007, there are still net declines averaging close to 12%.



It's important to emphasize that there was nothing magic about those late 2007 levels that somehow the markets "owe" to investors. And if, as we believe is likely, the market measures someday do reachieve those levels, it won't mean that markets are then finally "safe" once more. Decisions that need to be made today shouldn't wait till a former high water mark has been conquered. Volatility will always be with us. But, given current equity valuations relative to earnings, levels like those of late 2007 could well have more rational and durable economic underpinnings than prevailed at that time.

A Look Ahead to 2011

So, we believe that there is good reason to be optimistic about the year ahead. The overall jobs picture is beginning to look brighter (fewer new jobless claims, more new jobs) and the domestic residential real estate market is showing some positive signs. Interest rates are likely to remain very low for an extended period (probably at least through the end of this new year) and there is still a mountain of cash waiting to be deployed. Price/earnings ratios are still in their normal historical range, with corporate earnings looking brighter as the economy continues to improve. Most commentators are looking for 3% growth in the domestic economy for 2011.

We believe there is little risk of significant inflation due to still much under-utilized capacity, slow growth in employment, and a Federal Reserve which promises to put on the interest rate brakes to avoid inflation if need be.

Still, there are plenty of risks. Terrorist threats continue to unnerve many investors and "rogue" nations like North Korea and Iran remind us that not everyone wants to play by our rules. The war in Afghanistan looks unwinnable and its nuclear neighbor, Pakistan, unstable. The sovereign debt crisis in Europe could re-erupt in countries beyond Greece and Ireland and we have our own potential crisis in municipal finance brewing here at home. Our Chief Investment Officer, Jason Thomas, comments on the current municipal bond environment in the article following this.

The November election brought some - temporary - clarity to the US income and transfer tax situation with results that are generally very good for our clients. See the extended discussion by Kacy Gott, Ray Edwards, and Clay Stevens in the concluding article of this issue. Nevertheless, the problems of the US fiscal deficit and national debt are still with us. The Bowles/Simpson panel's cries for immediate and substantial measures to attack these problems achieved no traction. So far at least, the US isn't taking any cues from the austerity measures being adopted by many European countries. The new, more conservative Congress may force moves in this direction, with long-term positive economic benefits, but with lots of short-term trauma that could further unsettle markets.

On balance, we think the positives are likely to prevail, with riskier assets continuing to re-prove themselves to their many skeptics.

We, of course, are always available to our clients to discuss these issues in further detail, to carefully review their relevance to each of those clients, and to help our clients optimize the impacts for their specific circumstances.

Tim Kochis
Editor

Municipal Bonds: Reports of their death have been greatly exaggerated

Whether you're a muni bond investor…or a user of municipal services…or a taxpayer, you need to understand what may be in store for the muni bond market. We have better news for investors than they might expect though no great consolation for service users or taxpayers.

As the litany of investor concerns in 2010 – inflation, sluggish economic growth, Europe in debt crisis – has subsided, municipal bonds have taken center stage. The Great Recession has created a financial strain on state and local municipal bond issuers, with a few commentators predicting huge losses for municipal bond investors. In an *Investment Perspectives* to be published in January, we will go beyond the media's analysis to look more deeply into the municipal bond market. For now, here are our initial conclusions about

- the challenges facing issuers of municipal bonds,
- the safeguards for investors,
- scenarios in the case of default, and
- implications for our client portfolios.

Overview of the Municipal Bond Markets

The municipal bond market is very diverse and resists broad generalizations. Some reports put the number of municipal bond issuers at over 50,000, with millions of unique securities making up almost $3 trillion in value. Less than one third of municipal bonds outstanding are the direct debt of state and local governments, and of that about 9% of that is "pre-refunded" (collateralized by US government bonds)[i]. Most of the remainder are revenue bonds, half of which are utilities with rate-setting powers and generally less impacted by recession. Many universities, endowments, hospitals, and toll roads also issue tax-exempt bonds.

The historical experience of municipal bonds is that they very rarely default. Both the number of instances and the dollar impact have been small. According to the most recent studies from Moody's and Fitch, two municipal bond rating agencies, the 10-year cumulative default rates for *all* municipals, including high yield, are 0.09% and 0.58% respectively. Going back nearly 40 years, the vast majority of issuers (perhaps over 80%) in the municipal market that have defaulted did not have taxing authority, and were either part of the healthcare (typically special care facilities) or housing sectors.

Moody's Rated Defaults of 18,400 Rated Issuers from 1970 to 2009

	Number of Defaulted Credits	Size ($mn)
City	1	2
County	4	427
Electric Enterprise	2	2,375
Healthcare	21	1,328
Higher Education – Private	1	10
Housing Facilities	19	200
Privatized Student Housing	1	72
Recreation	1	98
Sewer Enterprise	1	3,200
Special District	1	20
Student Housing	1	37
Town	1	15
Grand Total	54	7,785
Total Rated Parity Debt Obligations	18,400	

Source: Moody's Housing Finance Rating Methodology & Housing Research, September 2007; Moody's U.S. Municipal Bond Defaults and Recoveries, 1970-2009, February 2010

Even during the Great Depression, when almost 4,800 issuers of municipal debt (7% of outstanding debt) defaulted between 1929 and 1937, most defaults did not last long and the estimated loss on the total was only about 0.5%.[ii] This modest impact is all the more surprising given the lack of economic stabilizing mechanisms (e.g., unemployment insurance, the FDIC) which did not then exist.

Because data is most readily available on state finances, we will focus our analysis there, commenting on local municipalities and other issuers as appropriate.

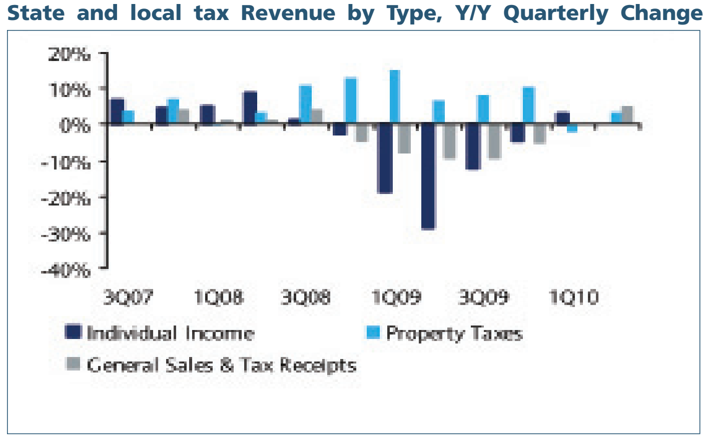
Challenges facing municipal issuers

There are two principal challenges facing municipal bond issuers today:

1. The Great Recession, which has substantially reduced tax revenue; and
2. The growing burden of pension and retiree health care obligations, much of which is unfunded.

The National Governors Association and the National Association of State Budget Officers recently released its biannual *The Fiscal Survey of States*, which presents data on the states' general fund receipts, expenditures, and balances. Total general fund tax revenues in FY 10 were $610 billion, a 10% decline from FY 2008, with effects in all three primary sources of state revenue: personal income, property, and general sales taxes.

State and local tax Revenue by Type, Y/Y Quarterly Change



Source: U.S. Census Bureau, Barclays Capital.

A number of states entered the recent crisis with existing budget gaps and underfunded pensions already on the books. The accumulation of further annual deficits is too large to be solved by a few years of good economic growth. According to the Center on Budget and Policy Priorities, 39 states together have a projected additional gap of $112 billion for FY 2012, to produce a cumulative total of $350 billion. California, Illinois, New York and Texas are the states with the largest budget gaps for FY 2012, accounting for 50% of the total.[iii]

Strong support for municipal investing

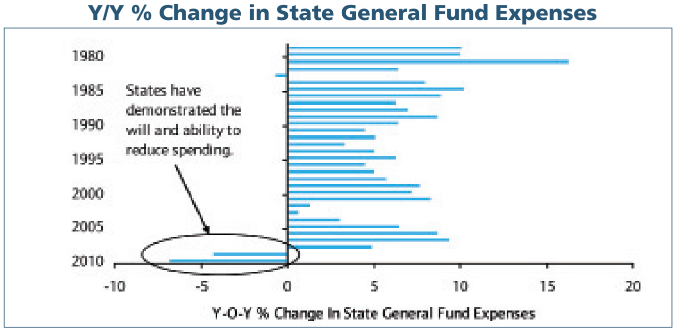
Contrary to common perception, there has not been an increase in defaults. Standard & Poor's reports that, year to date through November 1st, municipal bonds defaulted at roughly the same pace as in 2009 – a mere 0.3%. We believe that a significant increase in municipal defaults is unlikely, for a number of reasons[iv]:

Low current cost of debt service. The primary reason defaults are unlikely is that the cost of servicing debt is now very low for most municipal bond issuers, with interest payments representing a relatively small part of state and local budgets. While pensions represent a growing spending pressure and large unfunded liability for some, most of the actual pension expenditures will not be made for many years.

Opportunities for revenue enhancement. Even without tax rate increases, municipal finances will improve as the economy recovers. In addition, where they can, governments across the country are raising tax rates.

Opportunities for expense reduction. State and local governments have demonstrated the willingness to make difficult choices to maintain budget balance while making full and timely debt service payments, even in very stressful financial situations. The National Association of State Budget Officers reported that 43 states cut their budgets in 2009 and 42 did so again in 2010.

Y/Y % Change in State General Fund Expenses



Source: National Association of State Budget Officers, Barclays Capital.

Cost reductions have taken the form of delayed or cancelled projects (the rail tunnel between New Jersey and New York City is a well-known example), reduced services, and reduced public workforce.

Prioritization and protection. Security for general obligation (GO) and dedicated tax bonds is very strong, provided for in state constitutions, statutes, covenants with bondholders, and local ordinances. For local municipal issuers, GO bonds are secured by their power to levy and pledge property tax revenues for debt service. In recent decades, municipal bondholders have largely escaped big losses in bankruptcy cases because much of the debt has been secured by special liens and tax pledges that are protected.

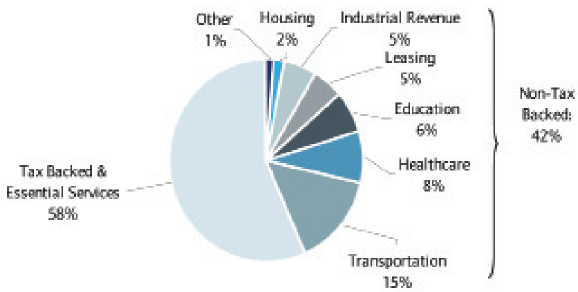
These elements of protection for municipal bond investors are reflected in municipal bond ratings. In November 2010, Moody's Investors Service affirmed the A1 rating and stable outlook on California's outstanding general obligation bonds, in spite of the near hysteria around the state's large deficits.

Implications for client portfolios

The fundamental truth of investing is that we must be willing to take risk to achieve a return, and the question should be whether all of the factors discussed above are reflected (albeit imperfectly) in market prices. That is, do the returns offered compensate for the risks that are present? It seems so – by almost every measure, municipal bonds are priced attractively relative to U.S. Treasuries and U.S. corporate bonds. In the current environment, the longer the maturity and lower the credit quality of a municipal bond, the more attractive its price is relative to historical averages. Consequently, Aspiriant takes an opportunistic and broadly diversified approach to municipal bonds, which includes allocations along both the maturity and the credit spectrums.

Our confidence in our approach to municipal bonds is bolstered by the diversity of the municipal market and the absence of the kind of interdependence which drove the financial crisis in September 2008. In many cases, a single municipality will issue several series of bonds, each supported by a different source of revenue. For example, the same city might issue GO bonds, utility revenue bonds, and bonds supported by a first lien on a citywide sales tax. Although the credit quality of each of the bonds is largely affected by the local economy, unique factors will influence the specific repayment scenarios.

Barclay's Capital High Grade Municipal, High Yield Municpal, and Municipal Taxable Indices - Market Value % by Source and Purpose Class



Source: Bloomberg, Barclays Capital

Still, there are certain common vulnerabilities – slow economic growth, still falling real estate values in some areas, and pension obligations, to name a few – and we may see an increase in the incidence of default among certain types of issuers, notably among smaller, non-essential projects from economically challenged areas, with cash flows that are not supported by taxes.

However, limiting investments only to tax-backed and essential service bonds would cut out a large and attractive portion of the market. In fact, this could be a counter-productive approach with yields on short-duration, high quality bonds currently offering a negative *real* (after inflation) rate of return.

Jason Thomas, Ph.D., CFA
Chief Investment Officer

[i] See Payden & Rygel, "Fact vs. fiction in the muni market", December 28, 2010.
[ii] Hempel, George. The postwar quality of state and local debt. New York; Columbia University Press, 1971.
[iii] Barclays Capital "Taxable municipal market commentary", December 3, 2010.
[iv] For additional details, see Fitch, "U.S. State and Local Government Bond Credit Quality: More Sparks than Fire," November 16, 2010.

From the CEO

2010 came to a close with another very good quarter for our clients' portfolios, capping an excellent year overall. Many of our newer clients are enjoying investment results accumulating to more than 50% over the past two years and many longer-term clients have recovered a very substantial portion of the losses incurred in the global financial crisis of 2008 and early 2009.

Quite a few commentators believe that that crisis is far from over and that many of the structural problems (excessive leverage, poorly executed or non-existent regulation, fiscal deficits, and more) are not cured or are now even worse. We are more optimistic; but we are not suggesting complacency. We remain very diligent in our efforts to identify specific world class investment solutions and to match intelligent investment strategies to our clients' goals and to their willingness and ability to tolerate the many risks that still…and always will… exist. We deeply appreciate their continued faith in our efforts.

In the year just finished, Aspiriant enjoyed substantial growth in clients and staff and geographic reach through the Aspiriant Investment Advisors subsidiary acquisition last September. Our core San Francisco and Los Angeles offices now celebrate three full years since the merger that created Aspiriant at the start of 2008. We continue to unleash synergies and expand client service capabilities for the benefit of all of our clients and continue to enhance career opportunities for all of our people.

On that very substantial foundation, we look ahead to 2011 with even deeper confidence in our ability to truly excel in serving our clients to help them achieve their goals. We intend, always, to be the leading independent wealth management firm, with our clients the chief beneficiaries of that leadership.

With very best wishes for a happy new year!

Rob Francais
Chief Executive Officer

New Tax Law

On one level, this is all good news: no increases in income tax rates and some small FICA tax savings (but still worth putting to work) and enhanced shelter from taxes on wealth transfers by lifetime gifts or at death. For quite a few clients, gift, estate, and generation skipping taxes have become irrelevant.

The bad news comes in two parts: the property transfer aspects of estate planning have become even more complex for many, especially those whose total estates are under $10 million, and this resolution of uncertainty lasts for only 2 years. If Congress and the President can't come to some new, long-term agreement, we'll be back to the unknown at the end of 2012.

Revised Recommendation on Recognizing Income from Roth Conversions

Probably the biggest impact of the new income tax law for Aspiriant clients and their tax advisors is the decision on when to recognize income from Roth conversions that took place in 2010. In the last two weeks of the year, we changed our default recommendations and revisited with clients and their outside tax preparers the optimal treatment of the tax associated with conversions during 2010.

For 2010, the first year that taxpayers with income in excess of $100,000 were eligible to make Roth conversions, a special income spreading provision allows the income to be recognized fully in 2010 **or** over the two succeeding years, 50% in each (so a $500,000 conversion in 2010 could be recognized as $500,000 of income in 2010 or as $250,000 of income in 2011 and $250,000 in 2012).

In the early part of the year, when we advised many clients to make at least a partial conversion, we had expected the current income tax rates to lapse at the end of 2010 and revert to the higher tax rates that preceded them. Consequently, unless the client was expected to be subject to Alternative Minimum Tax (AMT) in all three years (2010, 2011, and 2012) or had some other extenuating circumstances, our default recommendation was to recognize all the income in 2010. After the mid-term elections in November, when it looked like Congress would extend the current tax law for **one** more year, for many clients it still made more sense to recognize income in 2010, rather than face higher tax rates in 2012 for the second half of the Roth conversion.

The extension of the current tax rates for **two** more years causes us to now recommend taking advantage of the special 2010 income spreading provision and recognize the income over the two succeeding years, 2011 and 2012. The final decision does not have to be made until filing of 2010 tax returns (as late as October 17, 2011!) but for almost all clients, the split into 2011 and 2012 will be best.

The choice to defer income recognition means giving up the opportunity to tax any part of one person's IRA conversion in 2010 to take advantage of an unfilled rate bracket, for example. It's either all in 2010 or all split for 2011 and 2012. So, in some cases it was appropriate for a couple to convert part or all of one spouse's IRA and elect to recognize income for that in 2010 while still deferring and splitting the tax recognition on the other spouses' IRA conversion. All in all, thanks to Congress's last minute tax resolution, it was a far busier year-end than usual but, generally, much to the benefit of our clients.

On a much smaller scale, the one year relief on payroll taxes of 2% is also worth taking advantage of. For clients with employment income of $106,800 or more, this tax moratorium provides $2,136 in additional cash flow. Since no-one was expecting this, it's wise to plan, now, to put that small benefit to good use! So, to avoid just inadvertently spending it, plan an additional, upfront contribution of $2,000 into your 2011 savings program or make a fully incremental $2,000 gift to charity this year…or spend it, on purpose, on something really fun.

Kacy Gott
Chief Planning Officer

and

Ray Edwards
Director – Tax Services

Temporary Expansion in FDIC Insurance Coverage

While this may be of interest to only a few clients, it could be important to note that effective December 31, 2010 through December 31, 2012, the FDIC will provide **unlimited** insurance for all funds in **noninterest-bearing** accounts held at FDIC-insured institutions. Interest bearing accounts such as savings, money market, CD's and interest bearing checking accounts, continue to be insured up to the standard FDIC insurance coverage of $250,000 per depositor for combined accounts in the same institution.

Transfer Taxes Revisited: An Unexpected Holiday Gift from Congress

With a sharp increase in estate taxes looming, Congress finally got its act together in late December and passed comprehensive estate and gift tax legislation. Congress gave our clients an unexpected holiday gift when they not only agreed to extend low tax **rates** on gifts and bequests but revised all the estate tax rules in favor of ultra-affluent families. The substance of the changes can be summarized as:

- Fixed the tax rate for gifts, bequests, and generation-skipping transfer tax ("GST") at 35% for two years – instead of allowing it to increase to 55% on January 1, 2011.

- Increased the amount each person can pass estate tax-free at death to $5,000,000 per person – up from the $3,500,000 in 2009 and the mere $1,000,000 it would have reverted to otherwise on January 1, 2011.

- Reunified the gift and estate tax exemption so that each person can make taxable gifts during life of up to $5,000,000 without incurring actual gift tax. The exemption for gift tax purposes had remained at only $1,000,000 since 2001. This large new expansion provides substantial planning opportunities.

- Added a new "portability" feature to the estate tax and gift tax exemption allowing a surviving spouse to utilize his or her deceased spouse's unused exemption. This could allow a surviving spouse to pass as much as $10,000,000 tax-free.

- Increased the GST exemption to $5,000,000 per person for transfers during life or at death instead of allowing the exemption to revert to $1,000,000 on January 1, 2011. Unlike the exemption for estate taxes, however, the GST exemption is **not** portable and any unused amount cannot be used by a surviving spouse. This new $5 million exemption could be used retroactively against gifts originating in 2010.

- Restored the step-up in basis rules, resetting the basis for income tax purposes in most assets included in the estate to full fair market value and thereby eliminating gain from the later sale of those assets. This basis rule had been partially eliminated in 2010 as an offset to the one-year, 2010, repeal of the estate tax, but was completely restored on top of the very favorable new gift and estate tax rules.

- Added an option for the estates of taxpayers who passed away in 2010 (when there was no estate tax **and** no basis step-up) to elect to take a full step-up in basis on their assets in exchange for subjecting assets over $5,000,000 to a 35% estate tax.

The only real negative to this legislation is that it was not made permanent and all of these rules are only effective until December 31, 2012. If no further action occurs, we'll be back to a reversion to the old rates and exemptions of 2001. We don't think that that is the likely outcome. Meanwhile, however, as discussed below, there will be opportunities to fully capitalize on these benefits in these next two years even if Congress appears unlikely to extend them longer. We'll highlight some of the opportunities and pitfalls and discuss action items you should consider in light of these changes. To help illustrate these options, we'll look at five hypothetical families and analyze what steps each might consider now.

Transfer Tax Rates and Exemptions

	2009	2010	2011-12	2013
Gift Tax Rate	45%	35%	35%	55%
Estate Tax Rate	45%	35%/0%[1]	35%	55%
GST Tax Rate	45%	3.32%	35%	55%
Gift Tax Exemption	$1M	$1M	$5M[2]	$1M
Estate Tax Exemption	$3.5M	$5M[1]	$5M[2]	$1M
GST Tax Exemption	$3.5M	$5M	$5M[2]	$1.34M[3]

[1] For 2010, a decedent may elect a 0% tax rate but forgo an unlimited step-up in basis.
[2] Indexed for inflation, beginning in 2012.
[3] $1,000,000 indexed for inflation, beginning in 1998 (estimate as of 2010).
[4] Without further amendment, transfer tax law reverts to rates and prior law from 2001.

The freezing of the gift, estate and GST rates at 35% for two years produces an opportunity for larger estates to transfer more wealth to children and grandchildren with lower transfer taxes. However, for married couples with estates of $10,000,000 or less, the increased exemption amounts alone could prevent any of the estate from being subject to gift or estate tax. In addition, the heirs of such families receive an income tax benefit since most of those assets will receive a step-up in basis at death. The main risk in their plan is the possible expiration of the current law after 2012. Steps can be taken at the end of the 2012 to lock-in the transfer tax benefits if it appears Congress is going to allow the transfer tax rules to revert to 2001 levels. No substantive estate *tax* planning is necessary today, but making sure that property flows as intended will, for many, become even more important.

Case 1.

Joe and Mary Beth Johnson: Ages 65 and 66; $8,000,000 net worth, including $3,000,000 in capital gains in their real estate and stock portfolio. If we assume that their estate is unlikely to grow much further, under the current law, no estate tax would be imposed and they would receive a full $3,000,000 step-up in basis to avoid income tax upon the sale of assets post-death. No current estate **tax** reduction planning is crucial and, if it appears the new law is going to terminate at the end of 2012, then they could make taxable "gifts" outright or to trusts to utilize some of the $5,000,000 gift tax exemption each of them has. Our main consideration in making those taxable gifts would be Joe and Mary Beth's ongoing spending needs since they would have to give up access to the assets given away. A further consideration is whether to plan to use all…or any…of the $5 million exemption in the event one of them dies in these next two years. The best course of action is to establish a plan which provides flexibility on this decision in light of all the circumstances at the death of the first to die.

While elaborate tax-oriented estate planning may be unnecessary for many estates under $10,000,000, many other property management and family wealth distribution imperatives ("how much do I need to retain; how much can I afford to give away…and to whom?") will still apply.

For families whose estates are likely to grow substantially over $10,000,000 in the future or single taxpayers with $5,000,000 or more in assets, the increase in the *gift* tax exemption to $5,000,000 provides many opportunities for substantial estate tax planning without gift tax.

Case 2.

Mike and Amy Thomas: Ages 62 and 58; $9,000,000 net worth, consisting of a home valued at $4,000,000 (which was purchased 2 years ago for $5,000,000) and other investment assets. They are currently adding to their net worth and expect their home to rebound substantially in value. While no estate tax would be due upon death today, they could use estate planning techniques, such as a Qualified Personal Residence Trust or Residence Defective Grantor Trust, to freeze the value of the home at $4,000,000 or less for estate tax purposes. This would require the use of some of the Thomas's combined $10 million gift tax exemption, but could keep their taxable estate at death below their remaining combined exemption and prevent future estate tax on any recovery in the real estate value (which becomes especially important if the exemption returns to $1,000,000 in 2013).

Even if estate tax reduction planning is not currently urgent, families of any wealth should review the effects of the new laws on their existing revocable living trusts. The increase in the exemption to $5,000,000 raises some of the same funding concerns raised in 2009 when the exemption was $3,500,000. Plus, the new portability rules provide additional planning opportunities.

Case 3.

Michael and Denise Dickson: Ages 52 and 48; second marriage with children from prior marriages; $7,000,000 net worth, consisting of $5,000,000 of Denise's separate property and $2,000,000 in community property. Their current estate plan maximizes the Bypass Trust (the sub-trust that is exempt from estate tax at the Survivor's death) for the benefit of the first spouse's children and passes everything else to the Survivor. If Denise passed away first, the Bypass Trust would be funded with $5,000,000 and Michael would receive $2,000,000. In contrast, if Michael passed away first, the Bypass Trust would only be funded with $1,000,000 and the remaining $6,000,000 in assets would pass to Denise to be subject to tax at her death. With the new portability rules, all $7,000,000 of assets should be sheltered from estate tax at the survivor's death regardless of which died first. What would differ are the amounts subject to the survivor's control and the funds available to one set of prior marriage children versus the other. Regardless of *tax* exposure then, a careful review of the estate plan is in order.

Case 4.

Art and Bernice Campbell: Ages 70 and 71; first marriage with two children; $28,000,000 net worth. Their current estate plan provides that on the first death the exemption amount, or $5,000,000 would be held in the Bypass Trust and $23,000,000 would pass to the surviving spouse (without tax thanks to the marital deduction). Any appreciation on the $5,000,000 in the Bypass Trust assets after the death of the first spouse will not receive a step-up in basis at the death of the second spouse. The couple could simplify their estate by allocating everything to the surviving spouse at the first death (still no tax), relying on the portability exception to shield $10,000,000 from estate tax then, and obtaining a step-up in basis on 100% of the assets at the second death. Depending on what happens to capital gains rates versus estate tax rates in the future, it may be better to avoid capital gains taxes than estate taxes on the growth in assets in a Bypass trust. However, that may not be optimal for several reasons. First, the use of the Bypass Trust helps protect against future estate tax law changes in case the exemption available to the surviving spouse returns to $1,000,000 or the portability option is not renewed. Maybe more important, the Bypass Trust helps ensure the deceased spouse's distribution wishes are respected in case the surviving spouse remarries or becomes estranged from the children. The Bypass Trust also protects assets from the creditors of the surviving spouse. Lastly, the Bypass Trust permits full usage of the Campbell's GST exemption and may help avoid estate taxes when their children pass away.

While most of these issues relate to families with estates of $10,000,000 or less, the new legislation provides substantial benefits and opportunities for families with much larger estates as well. The increase in the gift and GST exemption to $5,000,000 provides lifetime opportunities for ultra-wealthy families to leverage their tax allowances and substantially decrease the amount subject to estate tax at death. With many estate tax strategies, such as Grantor Retained Annuity Trusts, Sales to Defective Grantor Trusts, and Family Charitable Remainder Trusts, families can shield five or ten times the exemption amount from estate tax at death.

While these strategies have been available for many years (and were not, as some feared, legislatively changed), the increase in the gift tax exemption allows families to make further use of them without incurring transfer tax – even when the size of the gift is large and/or the families have already used some or of all the prior $1,000,000 exemption. Moreover, for whatever portion of the estate is retained by very wealthy families and is subjected to estate tax, the tax is now at the relatively low 35% rate and is partially offset by the full step-up in income tax basis.

Case 5.

Robert Maxwell: Age 68; widowed; $90,000,000 net worth, consisting of real estate, various business interests, and a liquid portfolio of $30,000,000. Robert has made prior taxable gifts to his three children of $3,000,000 and eight grandchildren of $2,000,000 and paid gift tax. He plans very substantial charitable transfers, but any additional taxable gifts to family prior to January 1, 2011 would have created an immediate gift tax and he may not have had any GST exemption remaining to shelter assets in trust for grandchildren. With the increased exemptions, Robert might use a Defective Grantor Trust to "freeze" the value of the liquid $30,000,000. Instead of making a $3,000,000 taxable gift to "seed" the trust, he could now fund the transfer gift-tax free and shield all the growth from estate and GST tax in the future. Assuming an 8% pre-tax annual return and that Robert survives 15 years, he could shield perhaps $40,000,000 of growth from future tax and save more than $14,000,000 in estate tax. If the new 35% rate is allowed to expire for 2013 and beyond, the estate tax savings could be over $22,000,000. To the extent the assets continue to grow at 8% for 20 more years, the trust could pass as much as $140,000,000 at his children's death to grandchildren tax-free as well.

In summary, a conclusion about how to establish…or whether to change…one's estate plan is very fact specific and needs to be carefully considered with your estate planning counsel. Taxes are important considerations but other matters often prevail.

Clay Stevens
Director – Strategic Planning