THE BERNSTEIN REPORT

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Dear Reader,

The economy has created some uncertainty with respect to the tax proposals that were in the campaign platform of then Senator Barack Obama. There has been considerable discussion of additional stimulus in the form of middle-class tax cuts and spending packages. At the time this was written, specific details were not available. Certainly, there will be more information in budget proposals and probably passage of a bill late winter or early spring.

A pension recovery bill (Worker, Retiree, and Employer Recovery Act of 2008-H.R. 7327) was enacted in mid-December. The bill provides relief to retirees, employers and technical corrections to the massive "Pension Protection Act of 2006--PPA". The bill was essential due to the investment losses suffered by plan investments. Key provisions of the bill include:

- Suspension of required minimum distributions (RMDs) from IRAs, 401(k) s, 403(b)s, etc. for 2009. Individuals over 70 1/2 will not have to take any distributions from retirement accounts this year. No relief was provided for 2008. Hence individuals who reached age 70 1/2 during 2008 and have delayed taking the MRD until April 1st of this year will have to take a distribution for 2008 under existing rules. There was still interest in providing relief for 2008 when this was written.
- Nonspouse rollovers from qualified plans or 403(b)s that were discretionary under the provisions of PPA must be provided after 2009. This rule is different from a spousal rollover and provides that a nonspouse beneficiary of a decedent's retirement plan can stretch the MRDs over the life expectancy of such beneficiary if there is a trustee-to-trustee rollover of the funds.
- Defined benefit plan funding rules were relaxed to assist employers during the economic downturn. Funding target percentages were set at 92 percent for 2008 and 94 percent for 2009 and shortfalls must be made up in subsequent years up to the target levels, rather than 100 percent.

The Sec. 7520 interest rate (discussed) in our last letter dropped to 2.4 percent for this month, the largest single month drop and the lowest rate in history. Hence, some estate-planning techniques have become that much more lucrative. The inside report this month provides an interesting summary of tax items that must eventually be addressed by the new Administration.

Cordially,

Richard S. Bernstein

A Second Opinion Costs You NOTHING, But Could Save You MILLIONS!

WHEN IT COMES TO YOUR HEALTH, YOU GET A SECOND OPINION, SHOULD YOUR FINANCIAL WEALTH BE ANY DIFFERENT?

BATTLEGROUND TAXES

Tax legislation is enacted virtually every year and often there are several bills each year that include tax provisions. A number of tax bills have only limited implication and are hardly noticed, even in this letter. However we can anticipate some fundamental changes over the next couple of years with a new President and Congress. This occurred during the Bush Administration with two major tax laws passing in 2001 and 2003. Due to Congressional Budget rules and the limitations of the "Paygo" rules employed by Congress, the vast majority of these tax changes included expiration dates. Without further action, these provisions will revert to prior law.

There are a couple of issues affecting potential Congressional action. First, the Paygo rules that would require tax changes to be revenue neutral are no longer in effect. However, many in Congress would still generally push to follow this strategy. Second, the implications of the depth of the current recession may influence Congress to pass stimulus legislation that is not revenue neutral and would worsen the federal deficit. However, the national debt will eventually have an impact on future tax legislation and will probably cause some tax increases in the future, either through new taxes or the expiration of previously enacted tax reductions.

The Campaign Proposals of Barack Obama

The recession will have an impact on the immediate goals of Congress and President Obama. For example, there is a lot of discussion about the relatively quick passage of a stimulus bill that will incorporate tax relief. In addition, there may be a delay of some of the tax increases that were discussed in the campaign. However, the campaign proposals and statements of then candidate Obama provide a good starting point for understanding and anticipating the type of tax legislation that may be headed our way.

The individual tax provisions in the campaign included:

- An extension of the current tax rate structure only for those earning under $250,000 per year.
- An increase in both the long-term capital gains tax rate and dividend tax rate to 20 percent for those earning more than $250,000.
- The elimination of all capital gains taxes on start-up and small businesses.
- The creation of a $1,000 Emergency Energy Rebate to families (The rebate is planned to be paid for by adding a Windfall Profits Tax on oil prices exceeding $80 per barrel).
- A change to the nature of the child and dependent care credit by making the credit refundable (currently non-refundable).
- The allowance to low-income families of a 50 percent credit for childcare expenses.
- The creation of a "Make Work Pay" credit of up to $500 per working person or $1000 per family with income of up to $150,000.
- The expansion of the earned income tax credit (EITC).
- The elimination of all income taxes on senior citizens making less than $50,000 per year.
- The creation of a "Universal Mortgage Credit" of 10 percent for individuals unable to itemize their deductions.
- The creation of a refundable $4,000 credit for tuition.
- The expansion of the Savers Credit to make the credit refundable for families making less than $75,000 (50 percent of the first $1,000 in savings).
- The simplification of the tax filing process by providing taxpayers with the option of using pre-filled forms generated with income information provided to the federal government from third parties (i.e., banks and employers).

The business tax provisions in the campaign included:

- The termination of any tax breaks for companies that send jobs overseas.
- The enforcement of tax shelter and tax haven laws.
- The R & D credits would be made permanent.
- The extension of the Production Tax Credit for renewable energy sources.
- The elimination of special tax breaks for the oil and gas industry.

Key Tax Provisions Slated for Expiration

Estate and Generation-Skipping Transfer Taxes. The federal estate and generation-skipping transfer taxes were gradually reduced from 2001 to 2009 and scheduled for repeal (for one year only) in 2010. The law would revert in 2011 to the 2001 rules leaving an exemption of $1 million and marginal rates that reach as high as 60 percent. The Obama administration and Congress will have to address this fairly soon since it is unlikely that a one-year repeal will be permitted to occur. The initial thoughts were to freeze the taxes at the 2009 levels. The exemption amount would be $3.5 million with a maximum rate of 45 percent. No other components of the wealth transfer taxes would be changed. This strategy was introduced in the Senate in 2008.

A bill introduced last year in the House of Representatives to reform the wealth transfer taxes contained more complexity. The exemption would be reduced to $2 million (the level in 2008) and the maximum rate would be increased with the largest estates subject to rates above 50 percent. The House bill would also make the exemption amount portable. That is, a deceased spouse's exemption could be left to the survivor providing the survivor with a double exemption at the second death. The impact of this change would be a simplification of estate-planning documents for many married couples. The House bill would also make changes to the gift tax to re-unify the gift and estate taxes.

The most likely scenario is an exemption of at least $3.5 million and some negotiation over the maximum rate. The rate will probably remain fairly steep in light of a Democratic administration and a worsening federal deficit. Unfortunately, there is the possibility of continued uncertainty if a viable compromise can't be reached. The 2009 wealth transfer tax levels might simply be extended for a limited number of years and yet another expiration date.

15 Percent Tax Rate for Long-Term Capital Gains and Qualified Dividends. A lower long-term capital gain rate (also imposed for qualified dividends) was created in 2003 and extended through 2010 by subsequent legislation. Absent any changes, the lower rates (a zero percent rate is currently applicable to some taxpayers) will expire at the end of 2010. Subsequently, dividends will be taxed at the rates applicable to ordinary income and the long-term capital gain rate will return to 20 percent in most instances.

The lower rates would be removed under the Obama platform for individuals who earn more than $250,000. In light of the current recession, it is possible that this increase could be delayed or the lower rates could simply be allowed to expire as currently scheduled. A change in the tax code would be required to provide a different long-term gain rate based on the recipient's income level.

Other Important Expiring Provisions. There are countless individual provisions enacted during the Bush Administration that will expire soon. A large number of these were enacted in EGTRRA of 2001 that included an expiration date of December 31, 2010. Other provisions created over the last eight years have expiration dates between the end of this year and 2014. Some provisions have been addressed several times since their term was only one or two years. These are handled in the so-called "extenders" bill discussed every year in this letter. However, many major

provisions that are about to expire include:

- Individual marginal tax rates currently 25 to 35 percent would be returned to 28 to 39.6 percent. The Obama campaign statements would indicate an increase only in the top two brackets affecting those earning over $250,000 (single filers over $200,000).
- Itemized deductions currently have no limit, but would return to a complicated phase-out that dramatically increases the marginal tax bracket for some individuals.
- The child tax credit would be eliminated.
- The marriage penalty relief would be eliminated by reducing the allowable standard deduction and the size of the lowest tax bracket for joint filers.
- The estate and generation-skipping tax changes discussed above eliminated the estate tax at the state level in the vast majority of states. The state estate taxes based on the federal death tax credit would cause estate taxes at the state level in all states if the current law is simply allowed to expire without additional changes.
- Larger exemptions against the alternative minimum tax (AMT) would be eliminated and many millions of additional taxpayers would suffer this tax. There is bi-partisan support for complete reform or elimination of this tax, but the tax revenue price tag is high.
- Charitable donations from IRAs would no longer be permitted after this year. The tax benefit of this provision was made less relevant for affected individuals in 2008 as a result of the legislation suspending MRDs (discussed earlier in the cover letter).
- The deduction of state and local sales taxes would be eliminated.

The number of provisions that face elimination is staggering. These provisions affect every aspect of financial, estate, and retirement planning. The immediate concern of the government will be softening the impact of the current recession and stimulating the economy. However, the proposals of the incoming President and the countless expiring tax provisions add up to fundamental change to the tax structure. All this will ensue in the face of a staggering national debt. We'll keep you posted as soon as developments occur.

This Tax Letter is intended to assist you to conserve your estate and to protect the interests of your family and business associates. Estate planning involves the joint services of a competent Trust Officer, Attorney, Accountant, and Life Underwriter. The experience and advice of each is generally essential.

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