March 2013

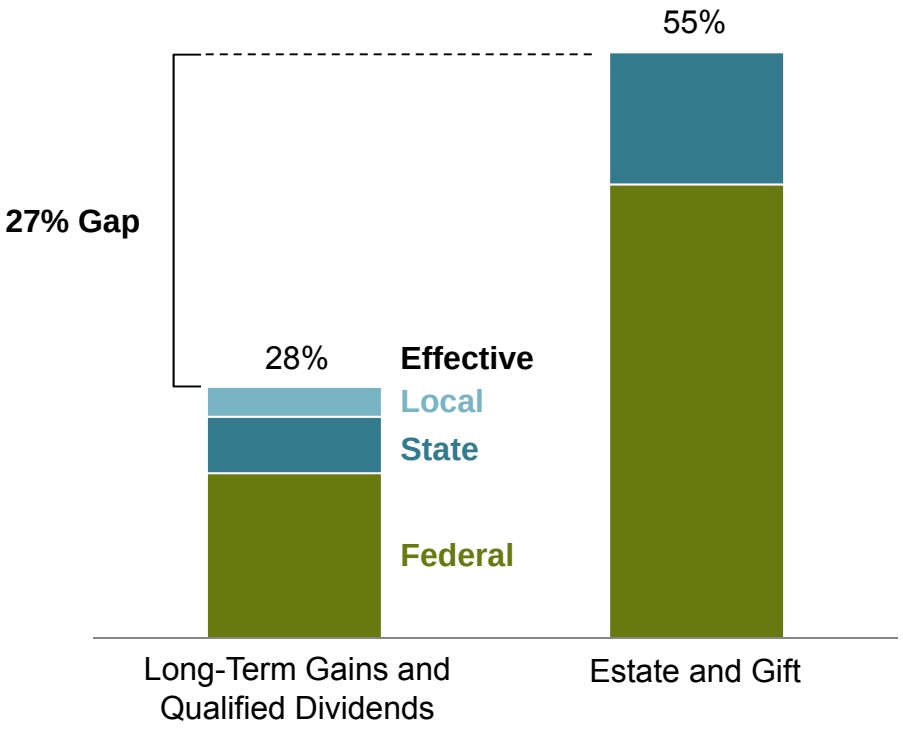
The ATRA-Math

Estate Planning After the American Taxpayer Relief Act of 2012

**Bernstein does not provide tax, legal or accounting advice.
In considering this material, you should discuss
your individual circumstances with professionals
in those areas before making any decisions.**

The Old Paradigm: When in Doubt, Transfer Out

2001: NYC Resident*



Federal Estate and Gift Tax Exclusion: $675,000
GST Exemption: $1,060,000

Estate Planning Recommendations

- During life, use the estate and gift tax exclusion
- Transfer wealth as quickly as possible
- Avoid estate tax inclusion at every generation
- Step-up in basis at death is less important because of the relatively low capital gain tax rates
- Income tax consequences are secondary
- State of residence will not significantly affect the plan

*"Estate and Gift": federal rate of 55% and state rate of 16%. "Long-Term Gains and Qualified Dividends": federal rate of 20%, state rate of 6.85% and local rate of 3.6%. Rates represent Bernstein's estimate of the top marginal tax, federal and state income, capital gains and estate tax brackets. Effective rates assume federal tax rates can be blended with applicable state tax rates by including federal deductions for state taxes. Bernstein is not a legal, tax or estate advisor. Investors should consult these professionals as appropriate before making any decisions.
Source: AllianceBernstein

A “Permanent” Fix to the Wealth Transfer Tax System

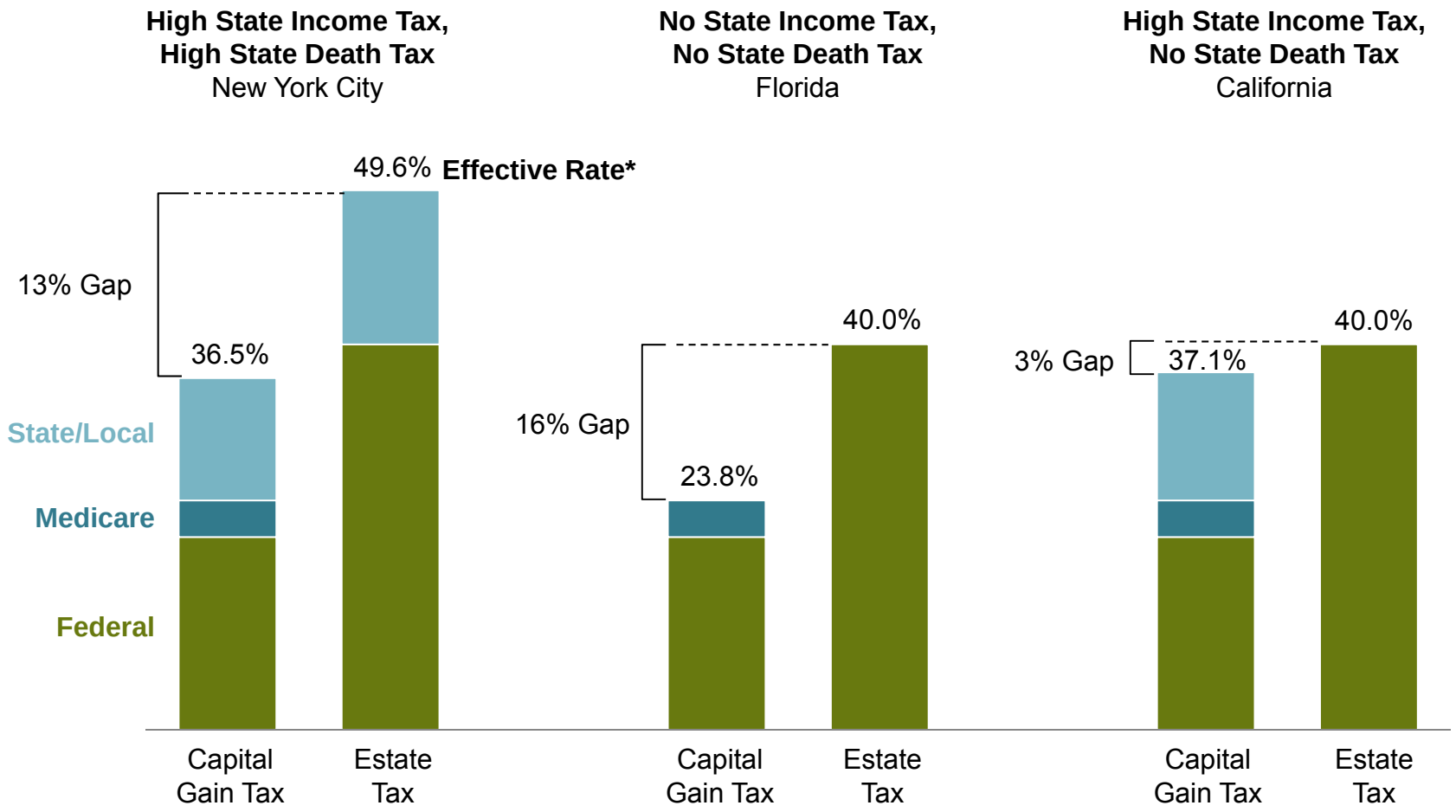
American Taxpayer Relief Act of 2012 (ATRA)*

- Reunification of gift, estate and generation-skipping transfer taxes
- **$5.25 million applicable exclusion amount for 2013 (indexed from 2011)**
- **40% transfer tax rate**
- Portability of “Deceased Spousal Unused Exclusion Amount”
- No sunset of the wealth transfer tax provisions

And don’t forget about the capital gain tax!

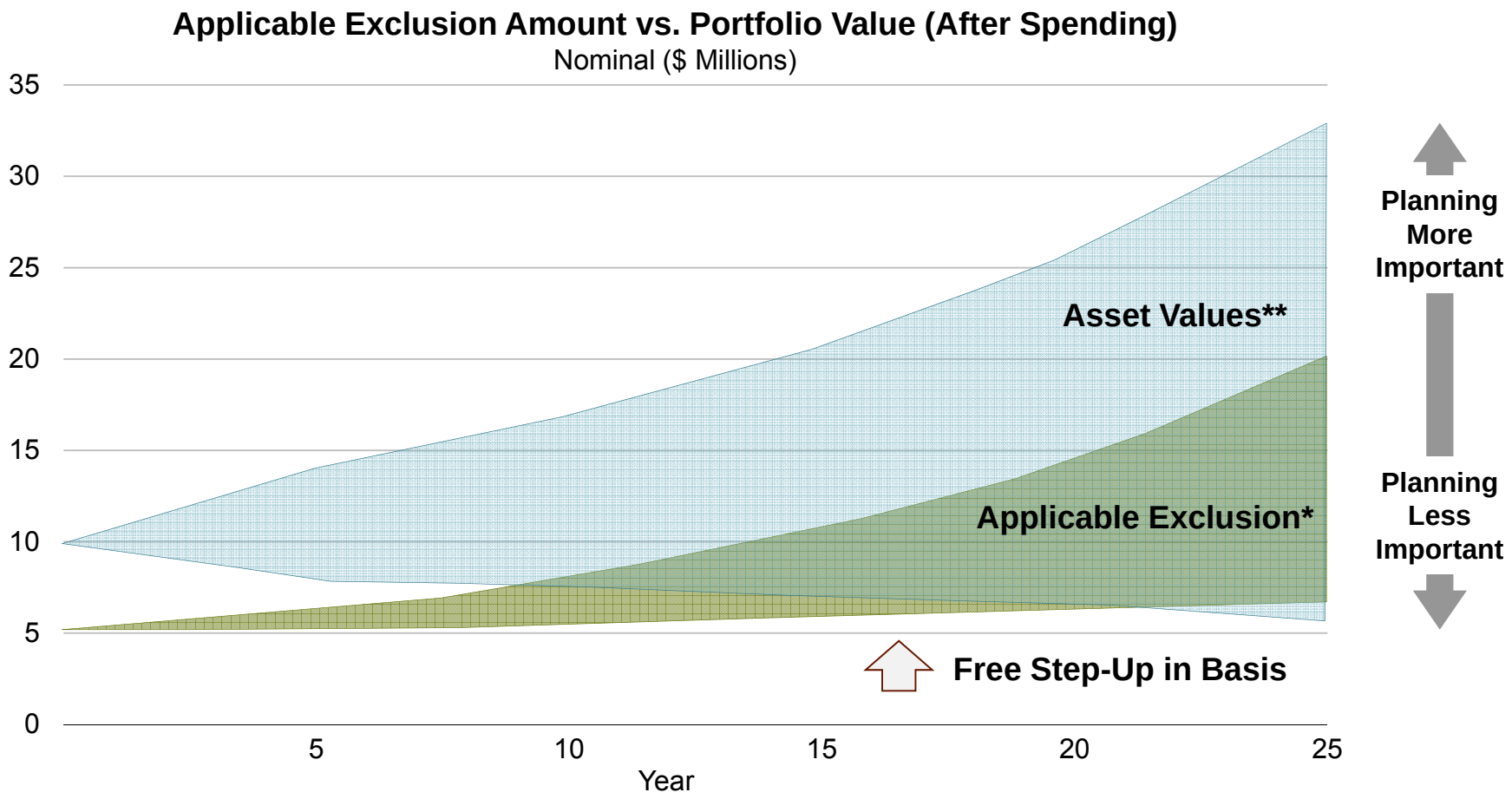
*P.L. 112-240, enacted Jan. 2, 2013

The New Landscape: Gap Has Narrowed—Where You Live Really Matters



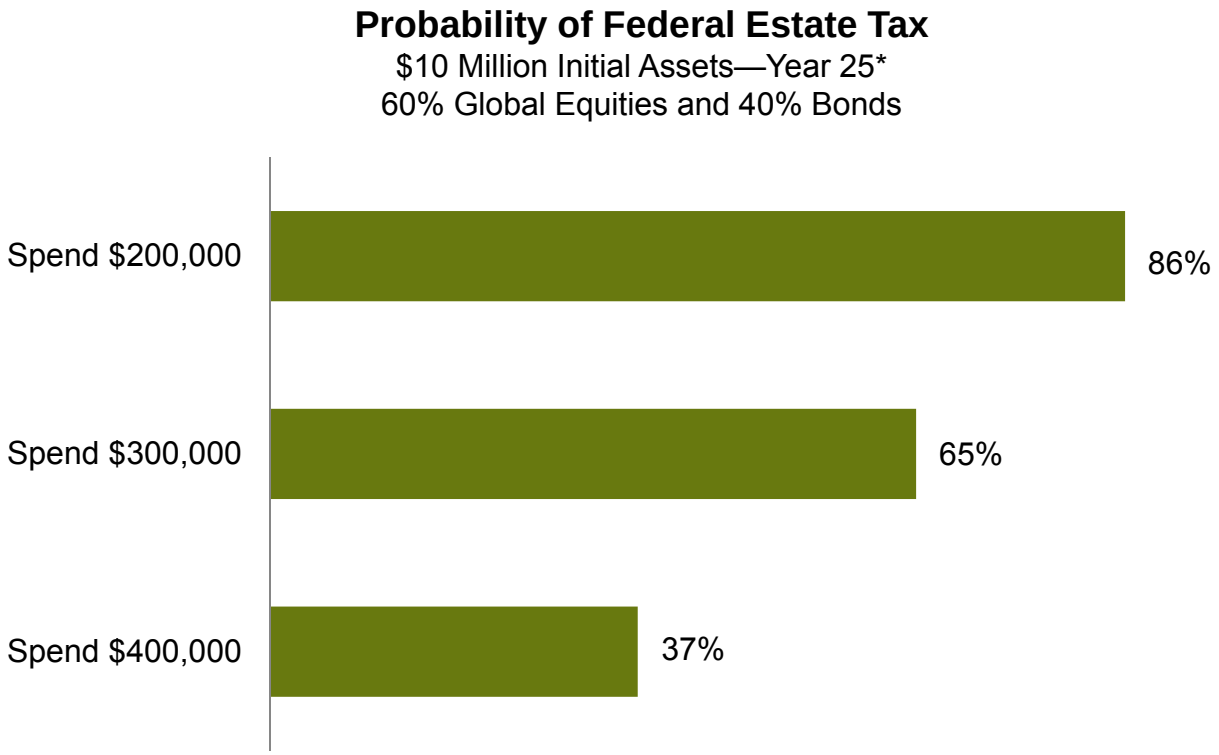
*Based on Health Care and Education Reconciliation Act of 2010 and the American Taxpayer Relief Act of 2012. Rates represent Bernstein's estimate of the top marginal tax, federal and state income, capital gains and estate tax brackets. Effective rates assume the taxpayers in New York City and California are in AMT. Bernstein is not a legal, tax or estate advisor. Investors should consult these professionals as appropriate before making any decisions.
Source: IRS and AllianceBernstein

Bernstein Can Quantify the Potential Outcomes



*Based on increases in inflation, rounded to the nearest $10,000. Applicable exclusion amount shown (green) is for an individual, based upon 10th and 90th percentile outcomes for the inflation-adjusted exclusion.
**Based upon 10th and 90th percentile outcomes. Assumptions: $10 million portfolio allocated to 60% global equities and 40% int-term municipals; $300,000 annual spending (inflation-adjusted); single-filer federal tax rates; 6.5% state tax rates.
Based on Bernstein's estimates of the range of returns for the applicable capital markets. Data do not represent past performance and are not a promise of actual results or a range of future results. See Appendix, Notes on Wealth Forecasting System, for details.

Will I Have an Estate Tax Bill?



You may need to do some planning, especially if you are a low spender.

*Portfolio assumed to be subject to top marginal federal tax and 6.5% state income tax. Probability of federal estate tax based on the likelihood of a $5.25 million real portfolio. All spending is adjusted for inflation. Based on Bernstein's estimates of the range of returns for the applicable capital markets. Data do not represent past performance and are not a promise of actual results or a range of future results. See Appendix, Notes on Wealth Forecasting System, for details.
Source: AllianceBernstein

Some Assets Benefit from "Step-Up"—Some Assets Do Not

Asset Type	Tax Characteristic
Creator-Owned Copyrights, Trademarks, Patents & Artwork	Ordinary ⇨ Long-Term
"Negative Basis" Commercial Real Property LPs	Ordinary and Long-Term
Artwork, Gold and Other "Collectibles"	28% Long-Term
Low-Basis Stock	20% Long-Term
Roth IRA Assets	Tax Free and No Surcharge
High-Basis Stock	Minimal Gain
Fixed Income	Typically Minimal Gain
Cash	Basis = Face Value
Stocks at a Loss	Capital Loss Erased
Variable Annuities	Partially IRD
Traditional IRA and Qualified Plan Assets	100% IRD

Source: AllianceBernstein

Gift vs. Step-Up: Case Study Assumptions

- Potential donor, a widow age 65, with $6.25 million liquid estate
  - $2 million of appreciated ABC stock
  - Remaining assets invested 60% in stocks, 40% in bonds*

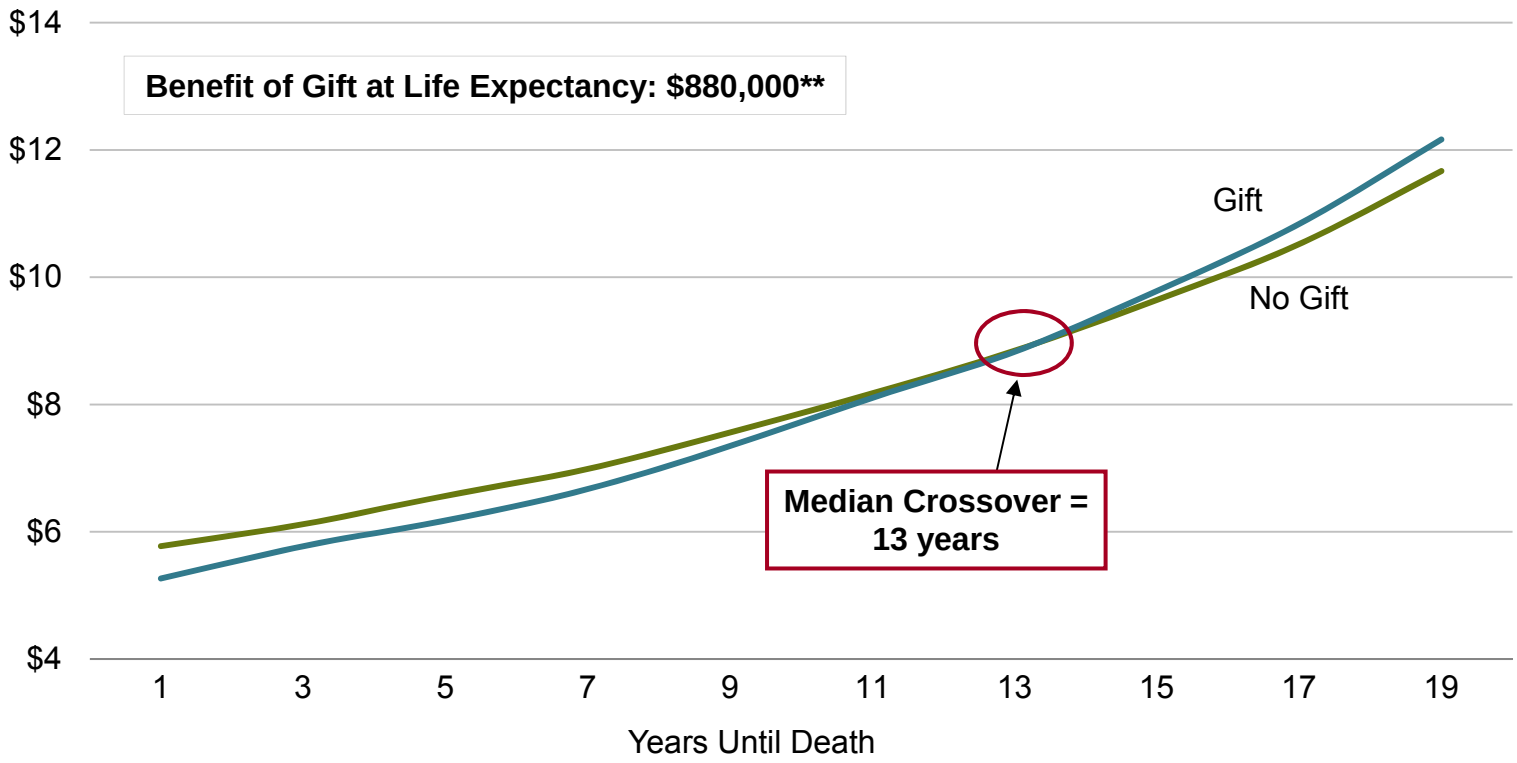
- Considering a gift to her child of the ABC stock…
  but concerned about a potential loss of step-up

Key research question: *How do the* ***many*** *undefined variables in this case affect the likely outcome?*

*"Stocks" means globally diversified stocks; "bonds" means intermediate-term municipal bonds. "Globally diversified" means 21% US value stocks, 21% US growth stocks, 21% US diversified stocks, 7% US small and mid-cap stocks, 22.5% developed international stocks, and 7.5% emerging market stocks. Spending is assumed to be offset by pension income; therefore, no spending has been modeled in this study.
See Appendix, Notes on Wealth Forecasting System, for details.
Source: AllianceBernstein

The Potential Benefit of a Step-Up Wears Off the Longer the Donor Lives

Median Value of Donee's Gift and Inheritance
After Estate and Capital Gain Taxes*
$ Millions, Nominal



NYC Donor

High State Income Tax

State Death Tax Exclusion = $1M

NYC Donee

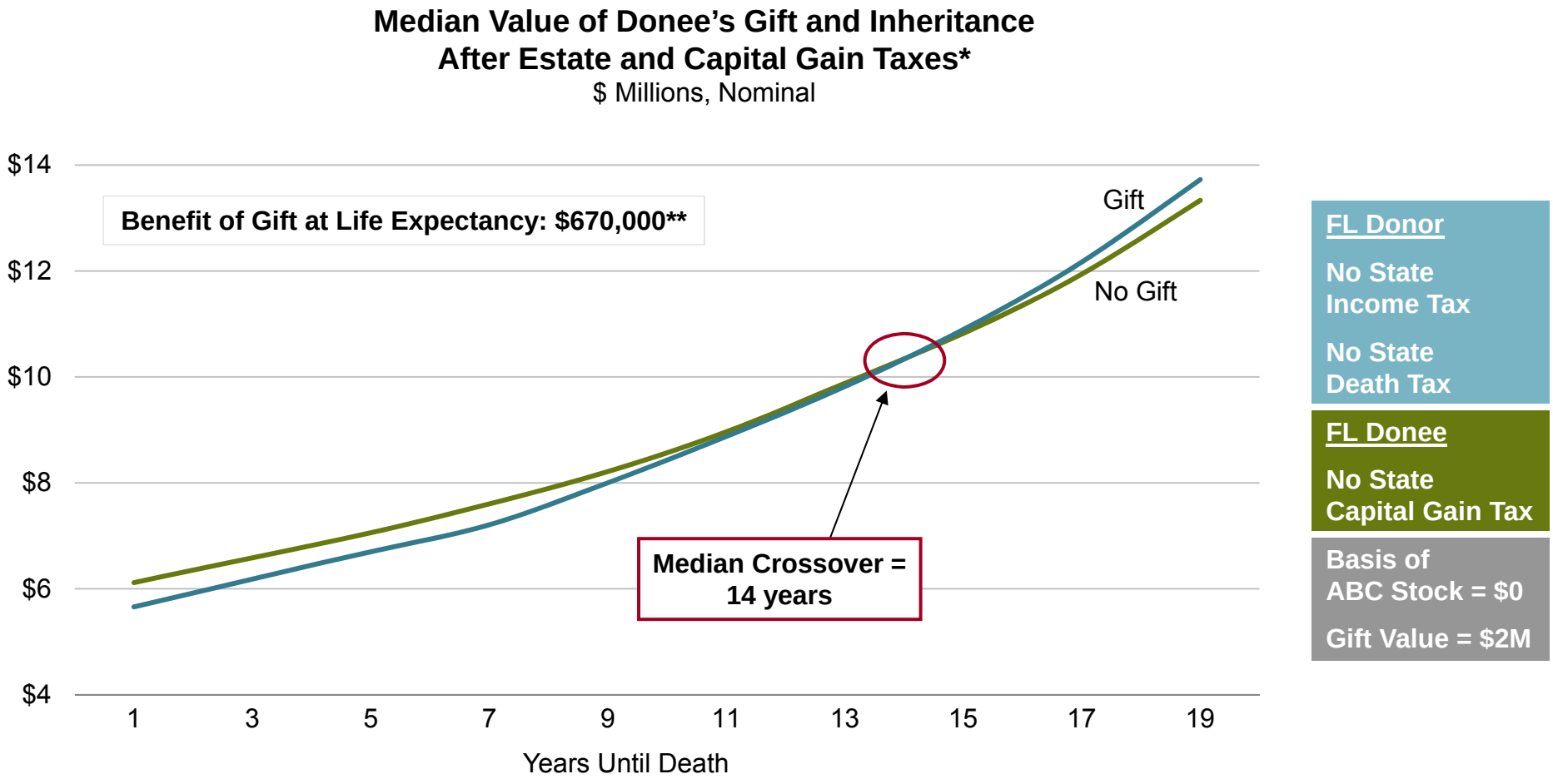
High State Capital Gain Tax Rate

Basis of ABC Stock = $0

Gift Value = $2M

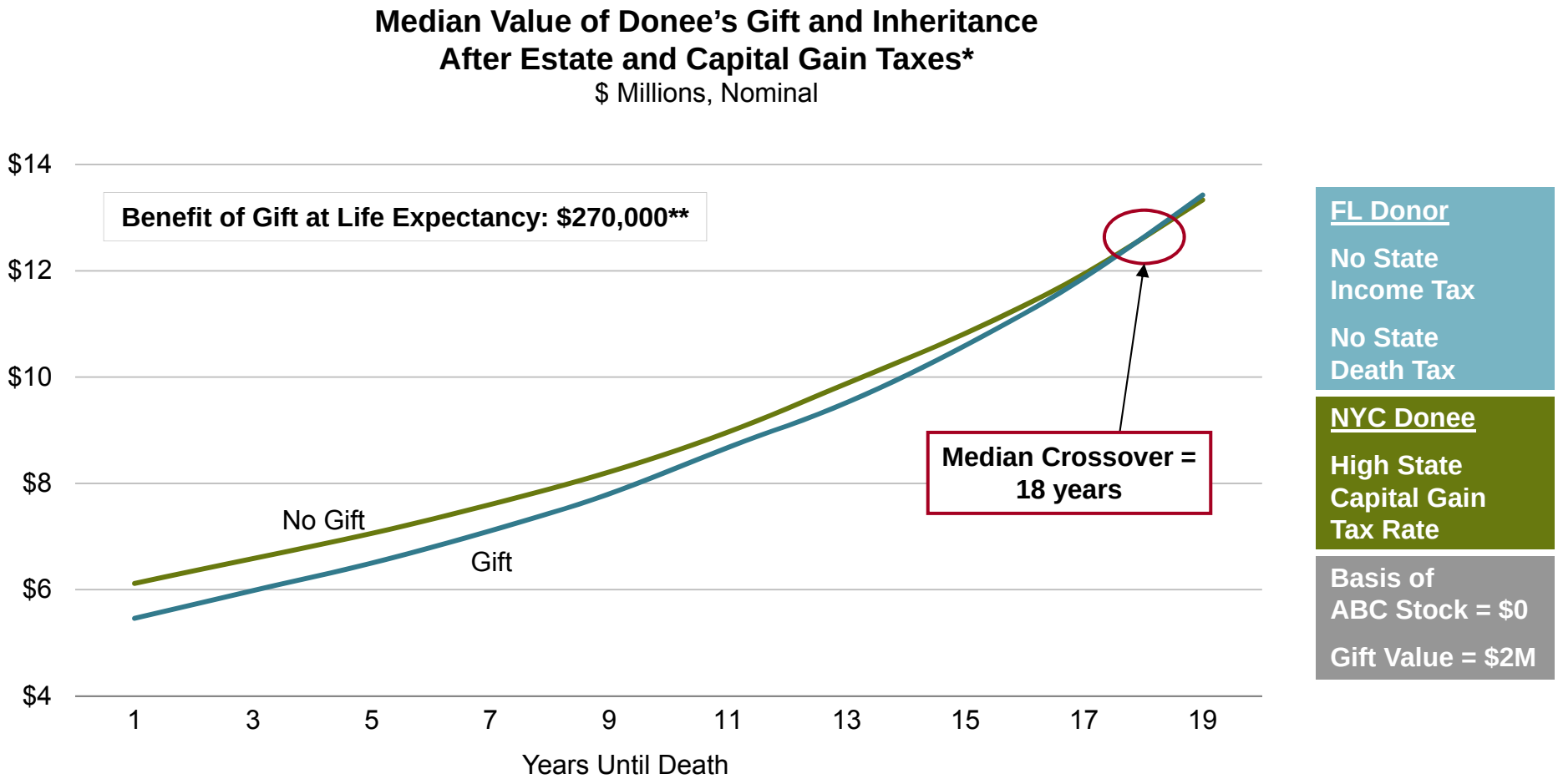
*Based on Bernstein's estimates of range of returns for applicable capital markets over the applicable period. Data do not represent past performance and are not a promise of actual results or a range of future results. Asset values represent estimated liquidation value net of capital gains tax assuming top federal and New York City tax rates. State estate tax at rates described in Section 2011(b) of the Internal Revenue Code of 1986, as amended, for taxable estate in excess of $1 million.
**23-year, life expectancy for a 65-year-old female is based on the Society of Actuaries RP-2000 Mortality Tables.
See Appendix, Notes on Wealth Forecasting System, for details.
Source: Society of Actuaries RP-2000 Mortality Tables and AllianceBernstein

The *Relative* Benefit of a Step-Up Doesn't Change Much When Both the Donor and Donee Are in a Low-Tax-Rate Jurisdiction



*Based on Bernstein's estimates of range of returns for applicable capital markets over the applicable period. Data do not represent past performance and are not a promise of actual results or a range of future results. Asset values represent estimated liquidation value net of capital gains tax assuming top federal rates.
**23-year life expectancy for a 65-year-old female is based on the Society of Actuaries RP-2000 Mortality Tables.
See Appendix, Notes on Wealth Forecasting System, for details.
Source: Society of Actuaries RP-2000 Mortality Tables and AllianceBernstein

As Expected, the Relative Benefit of a Step-Up Is More Valuable to a Donee in a *High*-Tax-Rate Jurisdiction



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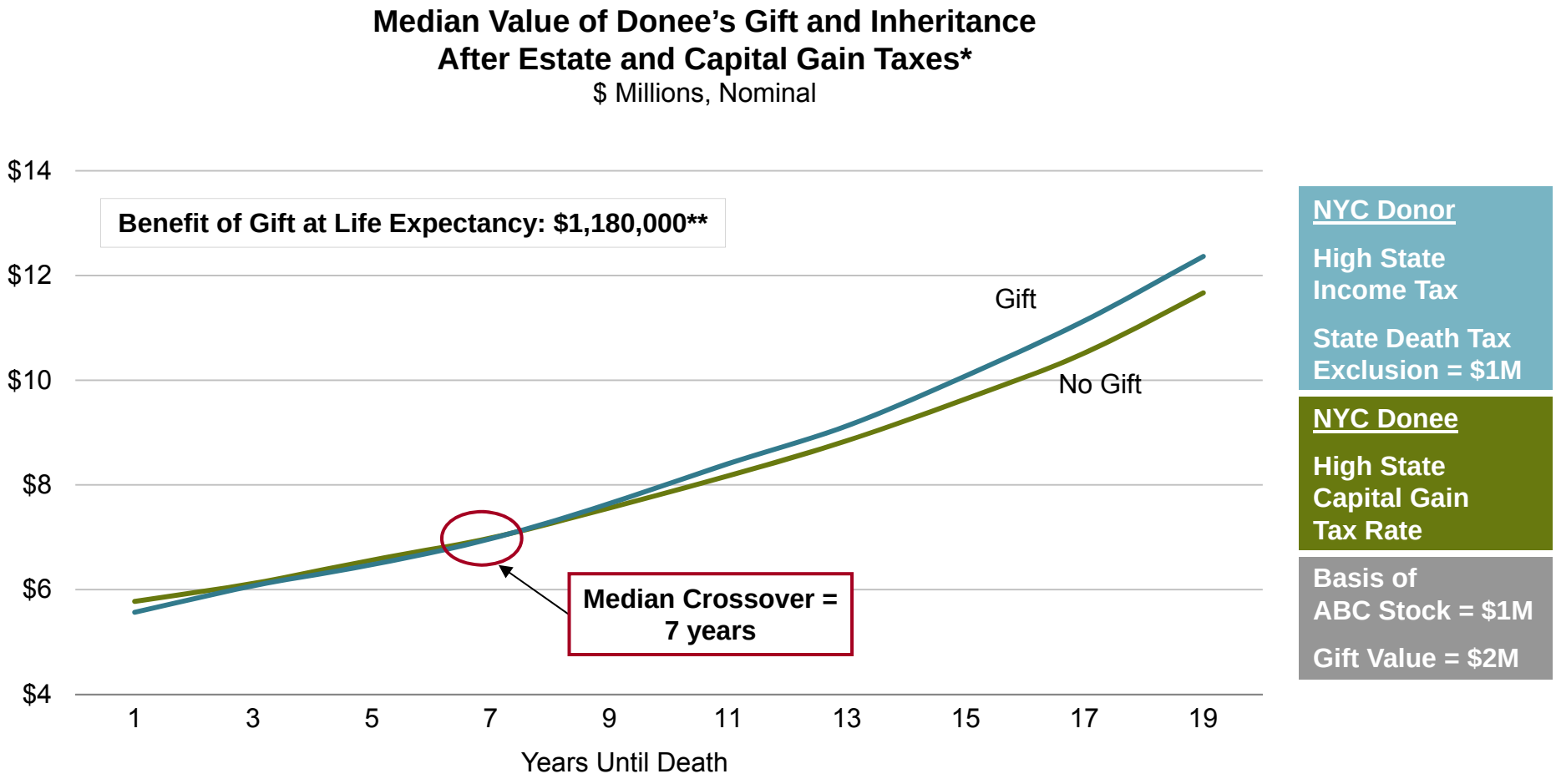
See Appendix, Notes on Wealth Forecasting System, for details.
Source: Society of Actuaries RP-2000 Mortality Tables and AllianceBernstein

And if the Donated Asset Has at Least *Some* Basis, a Step-Up Is Much Less Valuable to the Donee



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Source: Society of Actuaries RP-2000 Mortality Tables and AllianceBernstein

Crossover Depends on a Number of Factors

Years Until "Crossover"
Donor and Donee Domicile

Basis as Percent of Asset Value	FL	NYC	CA
0%	14	13	20
50%	9	7	13
100%	1	1	1

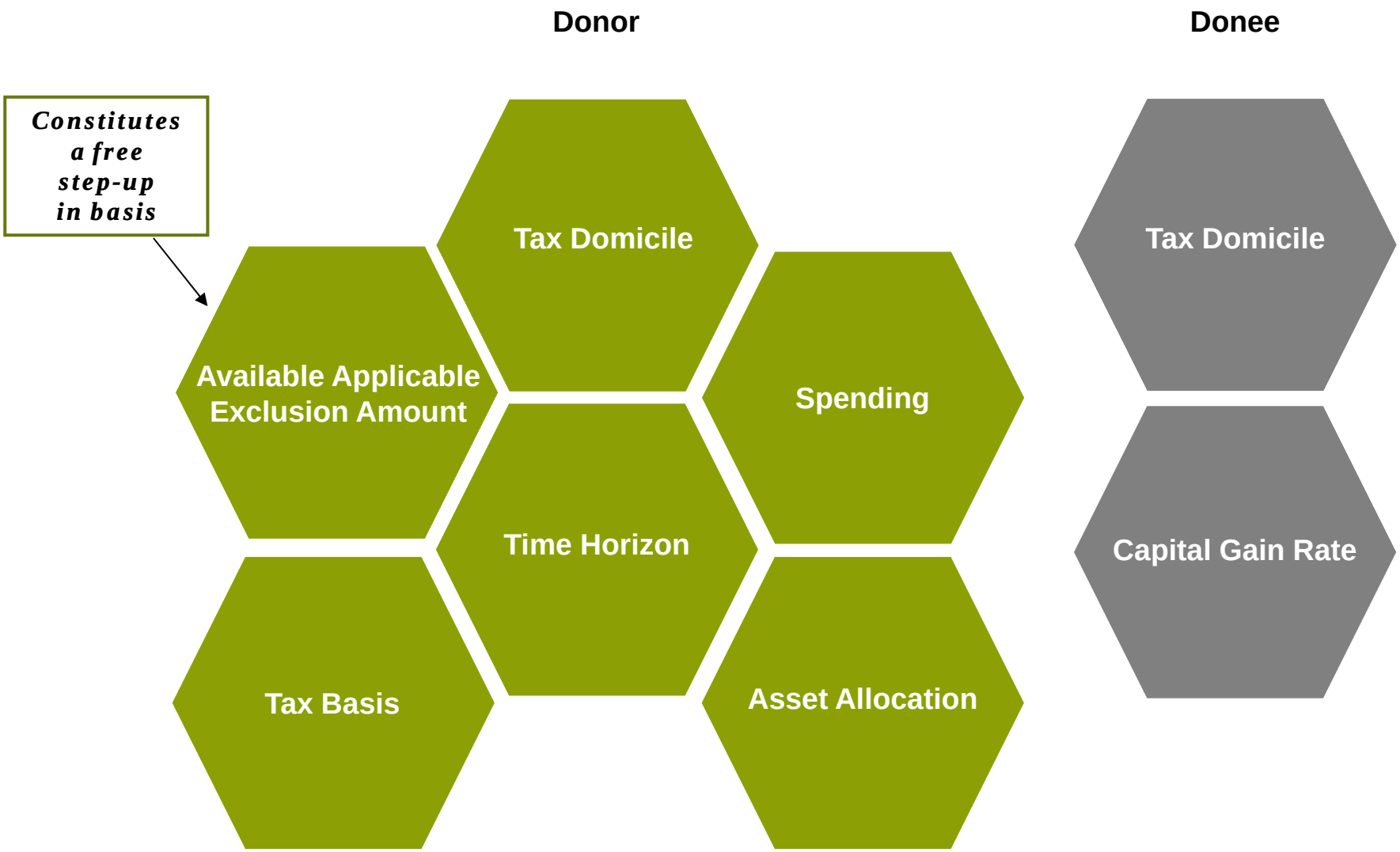
Zero basis asset
- Long wait for crossover
- Rarely makes sense to gift

Full basis asset
- Already at crossover
- Probably makes sense to gift

Leverage Bernstein's analytical capabilities to arrive at a customized solution for your client.

Crossover year based on median outcomes. Based on Bernstein's estimates of range of returns for applicable capital markets over the applicable period. Data do not represent past performance and are not a promise of actual results or a range of future results. See Appendix, Notes on Wealth Forecasting System, for details.
Source: AllianceBernstein

Today's Planning: Eight Key Variables to Consider



Source: AllianceBernstein

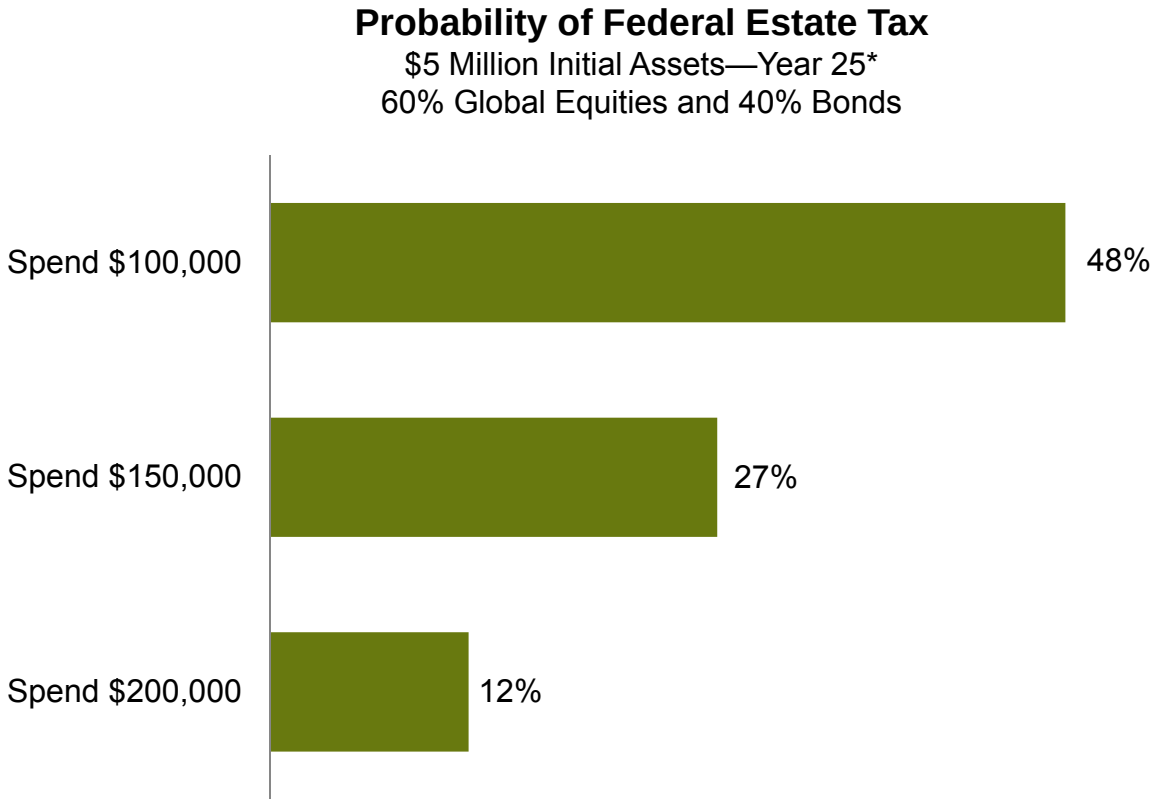
The New Paradigm

- Estate Planning
  - Infinitely more complicated (no fewer than eight variables will affect the estate plan)
- Applicable Exclusion Amount
  - Taxpayers should consider keeping as much as possible for the “step-up” in basis
- “Zeroed-Out” Transfers
  - Will mean more today than before
- Income Tax Considerations
  - Must be considered in tandem with potential transfer taxes
- Estate Tax Inclusion
  - Consider “reverse” estate planning and forcing estate tax inclusion even with GST tax exempt trust assets
- State of Residence
  - Each state will have a different set of recommendations based on separate or community property, income tax rates and state death tax rates

Source: AllianceBernstein

Appendix

Will I Have an Estate Tax Bill?



You may need to do some planning, especially if you are a low spender

*Portfolio assumed to be subject to top marginal federal tax and 6.5% state income tax. Probability of federal estate tax based on the likelihood of a $5.25 million real portfolio. All spending is adjusted for inflation. Based on Bernstein's estimates of the range of returns for the applicable capital markets. Data do not represent past performance and are not a promise of actual results or a range of future results. See Appendix, Notes on Wealth Forecasting System, for details.
Source: AllianceBernstein

Will I Have an Estate Tax Bill…and How Much?

$10.0 Million Portfolio
Year 25*
60% Global Equities and 40% Bonds

	Probability of Federal Estate Tax	Probability of >$1.0 Million Tax (Fed Only)	Probability of State Estate Tax	Probability of >$1.0 Million Tax (Fed/State)
Spend $200,000	86%	33%	>98%	66%
Spend $300,000	65%	16%	98%	41%
Spend $400,000	37%	7%	82%	20%

You may need to do some planning, especially if you are a low spender and subject to state estate tax

*Portfolio assumed to be subject to top marginal federal tax and 6.5% state income tax. Probability of federal estate tax based on the likelihood of a $5.25 million real portfolio. Probability of state estate tax based on the likelihood of $496,533 real portfolio (assumed $1.0 million state exemption that does not increase with inflation). State estate taxation based on New York estate tax brackets as of 2013, top marginal rate of 16%. Probability of >$1.0 million federal tax bill based on likelihood of $13.0 million portfolio in 25th year. Probability of >$1.0 million federal and state tax bill based on likelihood of $8.1 million portfolio in 25th year (assumes median rate of inflation). Based on Bernstein's estimates of the range of returns for the applicable capital markets. Data do not represent past performance and are not a promise of actual results or a range of future results. See Appendix, Notes on Wealth Forecasting System, for details.

Some Assets Benefit from a "Step-Up," Some Do Not

Asset Type	Comments
Creator-Owned Copyrights, Trademarks, Patents and Artwork	During the life of the creator of intellectual property and artwork, the creator has a zero basis in the asset, and all payments, whether from a sale of the asset or from the licensing of the property are considered ordinary income. On the death of the creator, the property is included in the estate and receives a step-up in basis to fair market value. The beneficiaries receive the asset immediately as a long-term capital gain asset. The foregoing does not apply to patents that qualify for and are sold under Section 1235 of the Internal Revenue Code of 1986, as amended, which qualify for long-term capital gain tax treatment.
"Negative Basis" Commercial Real Property LP or LLC Interests	Owners of partnership interests with "negative basis" would recognize long-term capital gain and ordinary income upon a taxable transaction due to accelerated depreciation and a reduction of the partner's share of debt. Upon death, the "negative basis" is eliminated because the partnership interests and the underlying property receive a step-up in basis (with a partnership election).
Artwork, Gold and Other "Collectibles"	Artwork and gold (including Gold ETF investments) are considered "collectibles" under the Code, and they are subject to a 28% long-term capital gain tax rate. Gains are also subject to the Medicare surcharge.
Low-Basis Stock	Capital asset subject to a 20% long-term capital gain tax rate and the Medicare surcharge. The step-up in basis eliminates the gain.
Roth IRA Assets	With a Roth IRA, the ordinary income tax of a traditional IRA has essentially been prepaid. Because the assets in a Roth IRA will grow income tax free, will be distributed tax free to the beneficiaries, and will not be subject to the Medicare surcharge, this is one of the better things to pass through the estate. Like other IRA and qualified plan assets, during life the owner is unable to gift the assets to non-charitable beneficiaries. As such, these assets are often includable in the estate of the decedent owner.
High-Basis Stock	Capital asset subject to a 20% long-term capital gain tax rate and the Medicare surcharge. Because the tax basis is high, very little gain is eliminated by the step-up in basis.
Fixed Income	Most fixed income investments are purchased at or near par and have very little appreciation potential above its basis. As such, very little gain is eliminated by the step-up in basis. A couple of exceptions to this rule include bonds purchased at a deep discount (e.g., ABRA-S) and long-duration bonds in a falling interest rate environment.
Cash	Basis of cash is always equal to its fair market value (face value).
Stocks at a Loss	Death constitutes a "step-down" in basis. The capital loss that the decedent could have recognized prior to death is eliminated and does not pass to the beneficiaries.
Variable Annuities	Payments are taxable as ordinary income and return of basis. The ordinary income portion is considered income-in-respect of a decedent (IRD). As such, on death, the beneficiaries continue to recognize the ordinary income portion of the payments, and there is no benefit to the step-up in basis.
Traditional IRA and Qualified Plan Assets	All assets in traditional IRAs and in qualified plans are considered 100% IRD (other than non-deductible contributions to IRAs). As such, there is no benefit to the step-up in basis at the death of the owner, and the beneficiaries continue to be subject to ordinary income (but not the Medicare surcharge) on any distributions. Because these assets cannot be gifted during life to non-charitable beneficiaries, these assets are problematic in that they often use up the decedent's applicable exclusion amount for estate tax purposes (unless passed to a spouse or charity). Any benefit from the IRD income tax deduction has been reduced because the transfer tax rate is lower (40%).

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Notes on Wealth Forecasting System

1. Purpose and Description of Wealth Forecasting Analysis

Bernstein's Wealth Forecasting Analysis[SM] is designed to assist investors in making long-term investment decisions regarding their allocation of investments among categories of financial assets. Our new planning tool consists of a four-step process: (1) Client Profile Input: the client's asset allocation, income, expenses, cash withdrawals, tax rate, risk-tolerance level, goals and other factors; (2) Client Scenarios: in effect, questions the client would like our guidance on, which may touch on issues such as when to retire, what his/her cash-flow stream is likely to be, whether his/her portfolio can beat inflation long term and how different asset allocations might impact his/her long-term security; (3) The Capital Markets Engine: Our proprietary model, which uses our research and historical data to create a vast range of market returns, takes into account the linkages within and among the capital markets, as well as their unpredictability; and finally (4) A Probability Distribution of Outcomes: Based on the assets invested pursuant to the stated asset allocation, 90% of the estimated ranges of returns and asset values the client could expect to experience are represented within the range established by the 5th and 95th percentiles on "box and whiskers" graphs. However, outcomes outside this range are expected to occur 10% of the time; thus, the range does not establish the boundaries for all outcomes. Expected market returns on bonds are derived by taking into account yield and other criteria. An important assumption is that stocks will, over time, outperform long bonds by a reasonable amount, although this is in no way a certainty. Moreover, actual future results may not meet Bernstein's estimates of the range of market returns, as these results are subject to a variety of economic, market and other variables. Accordingly, the analysis should not be construed as a promise of actual future results, the actual range of future results or the actual probability that these results will be realized.

2. Rebalancing

Another important planning assumption is how the asset allocation varies over time. We attempt to model how the portfolio would actually be managed. Cash flows and cash generated from portfolio turnover are used to maintain the selected asset allocation between cash, bonds, stocks, REITs and hedge funds over the period of the analysis. Where this is not sufficient, an optimization program is run to trade off the mismatch between the actual allocation and targets against the cost of trading to rebalance. In general, the portfolio allocation will be maintained reasonably close to its target. In addition, in later years, there may be contention between the total relationship's allocation and those of the separate portfolios. For example, suppose an investor (in the top marginal federal tax bracket) begins with an asset mix consisting entirely of municipal bonds in his/her personal portfolio and entirely of stocks in his/her retirement portfolio. If personal assets are spent, the mix between stocks and bonds will be pulled away from targets. We put primary weight on maintaining the overall allocation near target, which may result in an allocation to taxable bonds in the retirement portfolio as the personal assets decrease in value relative to the retirement portfolio's value.

3. Expenses and Spending Plans (Withdrawals)

All results are generally shown after applicable taxes and after anticipated withdrawals and/or additions, unless otherwise noted. Liquidations may result in realized gains or losses that will have capital gains tax implications.

Notes on Wealth Forecasting System

4. Modeled Asset Classes

The following assets or indexes were used in this analysis to represent the various model classes:

Asset Class	Modeled As…	Annual Turnover Rate
Intermediate-Term Diversified Municipal Bonds	AA-rated diversified municipal bonds with seven-year maturity	30%
US Diversified	S&P 500 Index	15%
US Value Stocks	S&P/Barra Value Index	15%
US Growth Stocks	S&P/Barra Growth Index	15%
Developed International Stocks	MSCI EAFE Unhedged	15%
Emerging Markets Stocks	MSCI Emerging Markets Index	20%
US SMID	Russell 2000	15%

5. Volatility

Volatility is a measure of dispersion of expected returns around the average. The greater the volatility, the more likely it is that returns in any one period will be substantially above or below the expected result. The volatility for each asset class used in this analysis is listed on the Capital Markets Projections page at the end of these Notes. In general, two-thirds of the returns will be within one standard deviation. For example, assuming that stocks are expected to return 8.0% on a compounded basis and the volatility of returns on stocks is 17.0%, in any one year it is likely that two-thirds of the projected returns will be between (8.9)% and 28.0%. With intermediate government bonds, if the expected compound return is assumed to be 5.0% and the volatility is assumed to be 6.0%, two-thirds of the outcomes will typically be between (1.1)% and 11.5%. Bernstein's forecast of volatility is based on historical data and incorporates Bernstein's judgment that the volatility of fixed income assets is different for different time periods.

6. Technical Assumptions

Bernstein's Wealth Forecasting System is based on a number of technical assumptions regarding the future behavior of financial markets. Bernstein's Capital Markets Engine is the module responsible for creating simulations of returns in the capital markets. Except as otherwise noted, these simulations are based on inputs that summarize the current condition of the capital markets as of December 31, 2012. Therefore, the first 12-month period of simulated returns represents the period from December 31, 2012 through December 31, 2013, and not necessarily the calendar year of 2013. A description of these technical assumptions is available upon request.

Notes on Wealth Forecasting System

7. Tax Implications

Before making any asset allocation decisions, an investor should review with his/her tax advisor the tax liabilities incurred by the different investment alternatives presented herein, including any capital gains that would be incurred as a result of liquidating all or part of his/her portfolio, retirement-plan distributions, investments in municipal or taxable bonds, etc. Bernstein does not provide tax, legal or accounting advice. In considering this material, you should discuss your individual circumstances with professionals in those areas before making any decisions.

8. Income Tax Rates

Bernstein's Wealth Forecasting Analysis has used various assumptions for the income tax rates of investors in the case studies that constitute this analysis. See the assumptions in each case study (including footnotes) for details. Contact Bernstein for additional information.

The Federal Income Tax Rate is Bernstein's estimate of either the top marginal federal income tax rate or an "average" rate calculated based upon the marginal-rate schedule. The Federal Capital Gains Tax Rate is the lesser of the top marginal federal income tax rate or the current cap on capital gains for an individual or corporation, as applicable. Federal tax rates are blended with applicable state tax rates by including, among other things, federal deductions for state income and capital gains taxes. The State Tax Rate generally is Bernstein's estimate of the top marginal state income tax rate, if applicable.

The Wealth Forecasting System uses the following top marginal federal tax rates unless otherwise stated: For 2013 and beyond, the maximum federal ordinary income tax rate is 43.4% and the maximum federal capital gain tax rate is 23.8%.

9. Estate Transfer and Taxation

The Wealth Forecasting System models the transfer of assets to children, more remote descendants, and charities, taking into account applicable wealth transfer taxes. If the analysis concerns a grantor and his or her spouse, the System assumes that only the first to die owns assets in his or her individual name and that no assets are owned jointly. It is further assumed that the couple's estate plan provides that an amount equal to the largest amount that can pass free of Federal estate tax by reason of the Federal unified credit against estate taxes (or, if desired, the largest amount that can pass without state death tax, if less) passes to a trust for the benefit of the surviving spouse and/or descendants of the first-to-die, or directly to one or more of those descendants. It is further assumed that the balance of the first-to-die's individually owned assets passes outright to the surviving spouse and that such transfer qualifies for the Federal estate tax marital deduction. Any state death taxes payable at the death of the first-to-die after 2010 are assumed to be paid from the assets otherwise passing to the surviving spouse. To the extent that this assumption results in an increase in state death taxes under any state's law, this increase is ignored. In addition, it is assumed that the surviving spouse "rolls over" into an IRA in his or her own name any assets in any retirement accounts (e.g., an IRA) owned by the first to die, and that the surviving spouse withdraws each year at least the minimum required distribution ("MRD"), if any, from that IRA. At the survivor's death, all applicable wealth transfer taxes are paid, taking into account any deductions to which the survivor's estate may be entitled for gifts to charity and/or (after 2010) the payment of state death taxes. The balance of the survivor's individually-owned assets passes to descendants and/or charities and/or trusts for their benefit. The survivor's retirement accounts (if any) pass to descendants and/or charities. To the extent that a retirement account passes to more than one individual beneficiary, it is assumed that separate accounts are established for each beneficiary and that each takes at least the MRD each year from the account. In all cases, it is assumed that all expenses are paid from an individual's taxable accounts rather than his or her retirement accounts to the maximum extent possible.

Notes on Wealth Forecasting System

10. Capital Markets Projections

	Median 25-Year Growth Rate	Mean Annual Return	Mean Annual Income	One-Year Volatility	25-Year Annual Equivalent Volatility
Cash Equivalents	2.7%	3.1%	3.1%	0.3%	8.2%
Int.-Term Diversified Municipal Bonds	2.8	3.0	3.2	3.7	6.0
US Diversified	7.8	9.4	3.2	16.3	17.2
US Value	8.1	9.6	3.8	15.8	17.0
US Growth	7.6	9.5	2.6	18.2	18.5
Developed International	8.5	10.4	3.8	17.9	18.0
Emerging Markets	6.6	10.5	3.9	26.6	26.6
US SMID	8.0	10.0	2.7	18.5	19.7
Inflation	2.8	3.1	n/a	1.0	8.7
Single Stock	3.8	9.4	2.2	34.8	34.0

Based on 10,000 simulated trials each consisting of 21-year periods. Contact Bernstein for additional information.
Reflects Bernstein's estimates and the capital market conditions of December 31, 2012.
Data do not represent any past performance and are not a guarantee of any future specific risk levels or returns, or any specific range of risk levels or returns.