LAW OFFICES

BERNETICH, HATZELL & PASCU, LLC

JOHN D. BERNETICH JR.
JAMES L. HATZELL*
PAUL PASCU

MEMBERS OF N.J. AND PA. BARS
* ALSO MEMBER OF FL. BAR

2 KINGS HIGHWAY WEST, SUITE 101
HADDONFIELD, NEW JERSEY 08033

TELEPHONE: (856) 795-3535
FACSIMILE: (856) 795-3322

WEBSITE: WWW.ESTATEPLANLAWYER.COM

CLIENT MEMORANDUM
November, 2003

In these closing months of 2003, the following are various estate and tax planning topics for you to consider:

- The **JGTRRA** (The Jobs and Growth Tax Relief Reconciliation Act of 2003) made the following notable changes:

  1. Certain phased-in income tax rate reductions were made by the 2001 Tax Act. The 2003 Tax Act accelerates the reductions so that the rates for 2003 are 10%, 15%, 25%, 28%, 33%, and the *new maximum rate of 35%*.

  2. The maximum tax rate on net capital gains is *reduced (from 20%) to 15%*. This generally applies to sales made on or after May 6, 2003.

  3. Effective for 2003, "qualified dividends" are taxed at the same rates as capital gains, that is, at a *maximum of 15%*. Previously, dividends were taxed at regular rates, up to 38.6%.

- **Federal Estate Tax.** In 2003, the Federal Estate Tax exemption is $1,000,000. Effective in 2004, the exemption becomes $1.5M. The tax rate is 45% on the excess over $1.5M up to $2M; and the rate on the excess over $2M is 48%. Essentially all assets are included as part of your Federal Taxable Estate, including real estate, pensions, life insurance, and most other assets.

- **New Jersey Estate Tax.** The New Jersey Estate tax exemption is $675,000. The New Jersey Estate Tax essentially applies as follows: on assets in excess of $675,000 up to $1,000,000, the effective tax rate is about 10%. On assets in excess of $1,000,000, the tax is about 6.4%, and it gradually increases to 16%. For example, if the estate is $1.5M, effective in 2004, the New Jersey Estate Tax will be about $65,000.

  Thus, if your estate is more than $675,000, estate tax planning is still needed.

  If your Will was drafted in 2001 or before, it should be reviewed. The Federal Estate Tax exemption has now increased, but the New Jersey Estate Tax now applies in cases where it did not apply before. In some cases, this will mean that, if your Will fully utilizes the Federal Estate Tax exemption, then the result may be an unnecessarily high New Jersey Estate Tax. *This problem will become more significant in 2004 when the Federal exemption increases to $1.5M*. It may be better to change your Will, so as to use only part of the Federal Estate Tax exemption, in order to reduce the New Jersey Estate Tax. This will vary from case to case, and it is advisable to review your situation, to determine to what extent a By-pass Trust will be appropriate. Many factors enter into the determination, including the size of your estate, your age, and your health, and your family circumstances.

- **Year-end Gifting.** It may be advisable to make year-end gifts. If your estate exceeds $675,000, there will be a New Jersey Estate Tax. In addition, if your estate exceeds $1.5M, there will also be a Federal Estate Tax. Although the Federal annual gift tax exclusion is currently $11,000 per donee, there may be additional benefits of making larger gifts.

- **Gifts for Tuition and Medical Expenses.** In addition to the above-mentioned annual exclusion of $11,000/person/year you may make gifts by paying tuition and medical expenses for your family members. Please note that the payments must be made directly to the school or the health care provider.

- **Distributions from Retirement Plans.** If you have reached age 70½, then you are required to make a withdrawal from your retirement plan, including your IRA. The minimum amount which must be withdrawn is called the "Required Minimum Distribution" (RMD). Generally, at age 70½ you must withdraw about $^1/_{25}$ of the balance in your account; and $^1/_{24}$ at age 72; and $^1/_{23}$ at age 73; and so on.

  It is also very important that you have in place an appropriate *beneficiary designation* for your retirement account. It is tax-advantageous to name an individual or a properly drafted trust for an individual as the beneficiary (rather than naming "my estate" as the beneficiary).

- **Power of Attorney.** Everyone should have in place a Power of Attorney, by which you grant to your spouse or to some other trusted person, the power to handle your affairs in the event you were to become incapacitated. Without a Power of Attorney, your family might need to apply for a guardianship, which would be very expensive and time-consuming and unpleasant.

- **Titling of Assets.** Joint ownership with right of survivorship (called JTWROS), is frequently *not* the best type of ownership, for estate tax purposes. If you have too many assets in JTWROS, then this could result in unnecessarily higher estate taxes on the "second estate". It is better to have at least some of your assets separately titled, that is, some assets in the husband's name and some assets in the wife's name.

- **Qualified Personal Residence Trust (QPRT).** This is a very favorable planning technique which allows you to transfer your house to your children in a manner which will reduce the estate taxes. Using this type of trust, you can retain the use and benefit of your home for a fixed number of years, and the transfer will take place in the future, but that transfer will be deemed made using today's value of your house rather than the future value. Whether you use a shorter term or a longer term for the trust will depend on your particular circumstances.

- **Self-canceling Installment Note (SCIN).** Another estate planning technique is for you to sell assets to your family members. This would provide cash flow, which could more than replace the income which you would no longer receive from those assets. It is possible to structure the transaction in a way that the note receivable expires (that is, it "self-cancels") at the time of your death, with the result that the note receivable would not be taxed as part of your estate. The Estate Tax savings could be huge.

- **College Savings Programs.** These are also known as *Section 529 Plans*. You can establish a tax-advantaged account to save for your children's or grandchildren's college expenses. You can make gifts to these accounts, and you can immediately use 5 years' of annual exclusions; for example, you might make a gift of $55,000, thereby using your $11,000 exclusion which would otherwise not be available except over the next 5 years. The monies can be used for tuition, housing, and books. So long as money is withdrawn only for those purposes, there will be no tax on any of the income earned, whether that is ordinary income or capital gains. You can also change the beneficiary at any time.

- **Guardianships and Trusts for Your Children.** It is very important that under your Will you appoint a guardian for your children who are under age 18. Also, it is not advisable to make any bequests outright to any child under age 18, because without other provision the monies would be held by the Office of Surrogate until the child reaches age 18. If you create a trust under your Will, then you can name a Trustee who will then manage and use the Trust for your children, which provides much greater flexibility. Also, it is frequently advisable to provide that the trust would last until your child is age 25 or 30. The following are some reasons for creating Trusts for your children:

  1. Protect against your child's creditors.

  2. Protect against claims of your child's spouse.

  3. Provide for distribution at a more mature age.

  4. Allow your child to obtain his/her own independence.

  5. Prevent the assets from being taxed as part of your child's estate.

  6. Protect and preserve assets for a child under disability.

- **Irrevocable Life Insurance Trust.** It is often said that life insurance is "not taxable". Generally, life insurance is exempt from *income* taxes. But life insurance is generally taxable for *estate* tax purposes. By placing your life insurance into an Irrevocable Life Insurance Trust (ILIT), then the estate tax can be avoided.

- **Changes in Family Circumstances.** <u>It is advisable to review your Will at least every three years</u>. There have been numerous changes in the Federal and New Jersey Estate Tax laws. Also, changes in your family circumstances including changes due to marriage, divorce, aging, or death, could affect your estate planning.

- **Medicaid Qualification.** It is possible that you or your parents may need to enter into a nursing home. The monthly expense might be $7,000 or more. You can qualify for Medicaid assistance to pay the nursing home expenses, but only if your assets are less than $2,000. There are planning techniques available under the law, by which <u>you can make gifts of interests in your home, and gifts</u> of other assets, to your family members, which will enable you to qualify earlier for Medicaid assistance. Also, for an older couple, rather than leaving your assets to each other, it may be advisable to leave your assets to a *trust for* your surviving spouse. The Trustee would keep the assets properly invested and utilized for your surviving spouse.

- **Living Will.** It is important that you have a Living Will which states your intentions regarding the maintenance or non-maintenance of artificial life support. The tragic case of Terri Schiavo, in Florida, well illustrates the problems of not having any Living Will.

In summary, due to changes in the estate tax laws and the dynamics of every individual's personal circumstances, <u>periodic review of your estate planning is important</u>. By taking steps to establish your estate plan, <u>you can reduce estate taxes and preserve assets for your family members, and otherwise make sure that your intentions will be carried out</u>.

Note: If your household income is above $293,000, you are in the top 1% for 2001; this top 1% of households paid 33.9% of all income taxes. The top 0.1% of households averaged $4,000,000 in income; they received about 8% of all income earned by all households, and they paid 16% of all income taxes. Those households making $28,000 or less comprise 50% of all American households.