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CLIENT MEMORANDUM

November, 2004

In nearing the end of 2004, the following are various estate and tax planning topics for you to consider:

- **Periodic Review.** It is advisable to review your Will at least every three years, and more often if there have been changes in your family situation (such as marriage, divorce, aging, births, death, or changes in your or a family member's health) or changes in your or a family member's financial circumstances. In addition, there have been numerous changes in the Federal and New Jersey Estate Tax laws which could affect your estate planning. Beneficiary designations on IRAs and life insurance acquired after your Will was prepared should also be reviewed.

- **Federal Estate Tax.** In 2004 and 2005, the Federal Estate Tax exemption is $1,500,000. The tax rate is 45% on the excess over $1.5M up to $2M; and, in 2005, the rate on the entire excess over $2M will be 47%. Essentially all assets are included as part of your Federal Taxable Estate, including real estate, pensions, proceeds of life insurance, and most other assets.

- **New Jersey Estate Tax.** The New Jersey Estate Tax "exemption" is $675,000. This exemption is not increasing. On an estate of $1.5 million, the New Jersey Estate Tax will be about $65,000. On assets in excess of $1,500,000, the tax rate starts at 6.4%, and it gradually increases to 16%.

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

  Your Will should be reviewed in order to ensure inclusion of provisions to avoid unnecessary taxes, especially if was drafted in 2001 or before.

- **New Jersey Inheritance Tax.** The New Jersey Estate Tax is distinct from the New Jersey Inheritance Tax. The New Jersey Inheritance Tax is zero for property passing to a spouse or descendants; 11% for siblings; 15% for all others.

- **Year-end Gifting.** It may be advisable to make gifts before December 31. The Federal annual gift tax exclusion is $11,000 per donee per calendar year.

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

- **College Tuition Plans - also known as *Section 529 Plans*.** You can establish a tax-advantaged account to save for your children's or grandchildren's college expenses. 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 change the beneficiary at any time.

- **Gifts and Valuation Discounts.** It is still very advisable to reduce your taxable estate by making gifts. *The element of valuation is the most significant issue in determining the taxation on a gift or on an estate.* Generally, if assets are kept and taxed as part of your estate after death, discounts for valuation are not applicable. If gifts are made during lifetime, under certain circumstances very substantial discounts can be applied, to significantly reduce the ultimate estate tax. This can be done by gifting a "minority interest" or a "non-voting interest" in a partnership or in real estate.

- **The Keri Case.** A recent New Jersey Supreme Court Case, decided on 08/05/04, authorized a guardian for an incapacitated person to make gifts, in order to allow that elderly incapacitated person to receive nursing home payments under Medicaid. Similarly, an agent under a Power of Attorney can make gifts for the principal in order for the principal to qualify for Medicaid if the power of attorney includes certain specific gifting provisions.

- **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. An effective power of attorney could be used to implement tax planning and to meet other critical needs.

- **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. You should designate a Health Care Representative in the Living Will; if you do not do so, then your family would need to go through a Court proceeding in order to have a Guardian appointed.

- **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. This 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.

- **IRA (Individual Retirement Accounts) - Beneficiary Designations.** It is 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 your "estate" as the beneficiary).

- **Roth IRA.** The Roth IRA can be a very advantageous tax planning technique. All principal and all future growth thereon will be paid out totally free of income taxes. There are no Required Minimum Distributions during the participant's lifetime, and your beneficiaries could extend the tax-free payout for many years.

- **Titling of Assets.** Joint ownership with right of survivorship (called JTWROS), is frequently *not* the best type of ownership. 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 assets titled individually in each spouse's name.

- **Self-canceling Installment Note (SCIN).** Another estate planning technique is for you to sell assets to your family members. This would provide cash flow, and the note receivable would not be taxed as part of your estate. The Estate Tax savings could be huge.

- **American Jobs Creation Act of 2004.** Now, it is easier to qualify as an S-Corporation; the number of eligible shareholders is increased to 100, and now certain family members will be treated as one shareholder. Individuals who take itemized deductions can now elect to deduct *either* state sales taxes *or* state income taxes. The amount of sales tax deduction can be based on actual taxes paid or by using IRS-prepared tables. These apply retroactive to January 1, 2004.

- **Working Families Tax Relief Act of 2004.** This Federal law was enacted on 10/04/04. It provides that certain tax cuts will be extended for at least one more year into 2005. The Alternative Minimum Tax (AMT) is sometimes a very significant tax, especially for those with many income tax deductions; the amount which is exempt from AMT will remain at $58,000 for couples. In 2005, the standard deduction for couples will be $10,000 ($5,000 for single taxpayers); the amount taxed at only 15% will be $59,400 ($29,700 for singles).

- **New Jersey Domestic Partnership Act.** On 07/10/04, Gov. McGreevey, signed a Bill, which allows same-sex couples, and also unmarried opposite-sex couples over age 62, to have certain legal status, granting some of the same rights afforded to married couples. Couples who wish to take advantage of this new law must register as "domestic partners". They must sign an affidavit, indicating that they live together and otherwise are "jointly responsible for each other's common welfare". Some of the benefits are: (1) exemption from New Jersey Inheritance Tax; (2) New Jersey State employees receive health insurance coverage for their same-sex domestic partners just as spouses do; (3) State and public employees may also be entitled to pension benefits for their same-sex partners.

- **New Probate Law in New Jersey.** There are many changes in the probate law, which will take effect in February 2005. Many of the changes might appear to be "technical", but they could have real effect. For example, children of a former spouse are now specifically defined to be "step-children" and they could receive part of your estate if you were to pass away without a Will.

- **Higher New Jersey Income Taxes.** In June, 2004 a law was passed, increasing the New Jersey Income Tax on income over $500,000 to 8.97% (from the prior maximum 6.37%). This is retroactive to January 1, 2004. This was dubbed the "Millionaire's Tax"!

- **Realty Transfer Fees.** For real estate transfers after August 1, 2004, if the price of the residential-zoned property, whether or not with a house, is more than $1 million, the buyer must pay an additional fee of 1% of the full price.

- **Capital Gains Exclusion on Sale of Home.** If you sell your home, and you are married, there is a $500,000 exclusion on capital gains from the sale. If you are single, that exclusion is $250,000. You must both own the home and use it as your principal residence for at least two of the prior five years. You could even have used it as a rental property during the other three years.

- **There are many types of trusts.** Each has certain advantages. Following are the most common types of trusts:

  (a) Revocable Living Trust. This allows you to maintain control over your assets, and also provides protection in the event of your becoming incapacitated during lifetime; it also provides for effective distribution of your assets after your death.

  (b) Irrevocable Trust. Gifts to such trusts will reduce estate and gift taxes. These trusts could also protect assets for heirs who are inexperienced or incapacitated, or who may be subject to lawsuits or other creditor claims. This is especially useful to remove life insurance from your taxable estate.

  (c) By-pass Trust (also known as Credit Shelter Trust). This takes full advantage of the estate tax exemption. This is generally necessary for your children to get the benefit of *both* parents' exemptions. Without such a by-pass trust, one of the parent's exemption is frequently wasted.

  (d) Charitable Remainder Trust. This is a trust which reduces income taxes, and allows you to retain income from property for a fixed period of time.

(e) Dynasty Trust. This enables you to preserve assets, and avoid estate taxes at the next generation or for several generations. This is also called a GST (Generation-Skipping Transfer) Trust. It can also serve to protect assets from claims against the beneficiary.

(f) Special Needs Trust. This provides for a beneficiary who has special needs (such as a disabled person) without causing the beneficiary to be ineligible for governmental financial aid.

(g) Qualified Terminable Interest Property (QTIP) Trust. This is a trust which provides benefits to the surviving spouse, while obtaining the benefit of the marital deduction for tax purposes, and while also earmarking the assets that will ultimately pass to your children from a previous marriage.

(h) Total Return Trust. This is a trust which allows for distribution of a fixed percentage of the assets, each year, to the beneficiary, without sacrificing the potential to be obtained from long-term investments.

(i) Qualified Personal Residence Trust (QPRT). This is a very favorable planning technique which allows you to transfer your house or a secondary residence 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.

(j) Asset Protection Trust. The purpose is to allow you to receive benefits from the trust, but to protect the assets from claims of creditors.

We also wish to say thank you to all of the clients for whom we have had the opportunity to be of service.