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*ESTATE PLANNING NEWSLETTER*

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### **New Tax Laws in New Jersey**

In October 2016, new laws were enacted in New Jersey, which provide for the following changes to taxes:

- **New Jersey Estate Tax** is reduced in 2017, and then repealed effective January 1, 2018
- **New Jersey Income Tax** exclusion for married retirees is gradually increased to \$100,000
- **Gasoline tax** is raised by \$0.23 per gallon
- **Sales tax** is reduced from 7.0% to:
  - 6.875% effective on January 1, 2017, and
  - 6.625% effective on January 1, 2018

Some of these changes are discussed in more detail in this newsletter.

### **Estate and Inheritance Taxes**

#### ***New Jersey Estate Tax***

Currently, the New Jersey Estate Tax Exemption is \$675,000 and the highest marginal tax rate is 16%. Under the new law, the repeal is phased in, with the exemption to apply for decedents dying in the years as follows:

- 2016 – exemption remains at \$675,000
- 2017 – exemption is \$2,000,000
- 2018 and thereafter – estate tax is fully repealed

*Note: Amounts passing to spouses continue to be fully exempt.*

With this change, New Jersey becomes a state with one of the lowest estate tax burdens, whereas previously it was a state with one of the highest estate tax burdens.

#### **New Jersey Retirement Income Exclusion**

For New Jersey residents with retirement income, the amount of retirement income that is excluded from gross income is increasing each year through 2020. For married couples filing jointly, the exemption amount is increasing from \$20,000 in 2016 to \$100,000 in 2020. For single taxpayers, the exemption amount is increasing from \$15,000 to \$75,000. This exemption is only applicable for taxpayers who are 62 or older or disabled and whose gross income does not exceed \$100,000.

#### ***New Jersey Inheritance Tax***

The New Jersey Inheritance Tax (which is distinct from the New Jersey Estate Tax) remains unchanged. Amounts passing to a spouse or descendants are exempt from the Inheritance Tax. Amounts passing to siblings are taxed at a rate of 11% or greater, and amounts passing to others are taxed at a rate of 15% or greater. The Inheritance Tax applies to assets owned at death, as well as gifts made within three years of the date of death.

#### ***Pennsylvania Inheritance Tax***

Amounts passing to a spouse are exempt from the Pennsylvania Inheritance Tax. Amounts passing to children are taxed at a rate of 4.5%. Bequests to other beneficiaries are taxed at 12% or 15%.

#### ***Florida Estate Tax***

Florida has no state estate or inheritance tax. Florida residents only need be concerned with Federal Estate Tax.

#### ***Federal Estate Tax***

The Federal Estate Tax (FET) remains in place. The FET exemption is adjusted each year for inflation. Currently, the exemption is \$5,450,000. The exemption for 2017 will be \$5,490,000. Also, the current law permits "portability" of the FET exemption from one spouse to the surviving spouse. Portability allows for one spouse to leave all of his or her assets to the surviving spouse tax-free using the marital deduction. The unused FET exemption can later be used by the surviving spouse's estate, thereby effectively allowing the surviving spouse to have an exemption of \$10,980,000.

### **Trusts in Medicaid Planning**

A recent survey reports that the average cost of a skilled nursing facility in our region is approximately \$10,000 per month. Thus, there is a significant incentive to become eligible for Medicaid.

Medicaid eligibility requires both a resource test and an income test. For the resource test to be met, a single person can own only \$2,000 in assets and a married

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## Reasons for Using Trusts in Estate Planning

Traditional by-pass trust planning is very important for married couples where it is probable or even possible that the assets in their combined estates could exceed \$10,980,000. If a by-pass trust is funded upon the first spouse's death with the Federal Estate Tax exemption amount of \$5,490,000, that trust, **and all appreciation** in that trust, will be excluded from the surviving spouse's estate upon his or her death. Under this approach, it is possible to pass significantly more than \$10,980,000 to your children or other beneficiaries free of Federal Estate Tax.

For smaller estates, the repeal of the New Jersey Estate Tax eliminates one motivation for including a trust for the surviving spouse in estate planning documents. Prior to this change, a significant goal of estate planning in New Jersey was to double the amount a couple could pass estate tax-free from \$675,000 to \$1,350,000. This planning was implemented by titling assets equally between both spouses, and passing assets into a trust for the benefit of the surviving spouse.

After the January 1, 2018 repeal of the New Jersey Estate Tax, this type of by-pass trust planning will no longer save tax for couples whose assets total less than \$10,980,000. There will usually be no **estate tax** detriment if the assets are titled jointly or in one spouse's name, and if all the assets pass outright to the surviving spouse upon the first spouse's death. This can greatly simplify many estate plans. However, there are many **non-tax** reasons why a trust for the benefit of a surviving spouse and for other beneficiaries is still desirable.

There are many options and considerations when creating trusts, including income taxes and capital gains taxes. Depending on your goals, the terms of trusts can be very flexible to the beneficiary or very restrictive. In many cases, the beneficiary can be the trustee of his or her own trust. It is important to evaluate what is most appropriate for each situation. Some of the purposes of trusts include:

- **To Hold Assets for Minor Children and Young Adults.** If you have a minor child or young adult beneficiary who may not have the experience or maturity to manage a lump sum upon your death, assets can instead pass to a trust to be invested and distributed to your beneficiary by a trustee of your choosing. When the beneficiary reaches a certain age (an age you choose), he or she could receive the remaining balance outright.

- **To Protect from Various Types of Claims.** A trust can provide significant protection against claims of a beneficiary's creditors, including a spouse in the event of a divorce. This type of protection can be especially beneficial if your beneficiary is in a high-risk profession. Additionally, if your beneficiary is in bankruptcy, a trust can provide important protections while still allowing the trust assets to be used for the benefit of your beneficiary.

- **To Preserve Eligibility for Government Benefits.** If a beneficiary were to receive assets outright, he or she could be disqualified from receiving need-based benefits, such as SSI and Medicaid. If the assets were instead placed into a trust, the assets could be available to be used for the beneficiary without causing disqualification from certain benefits. A more detailed description of these types of trusts, sometimes called Special Needs Trusts, is on Page 3.

- **To Protect from Estate Taxes.** A trust can be used to avoid estate taxes on your beneficiary's ultimate estate. Depending on the circumstances, this could provide a significant savings to that beneficiary's children. For example, if you were leaving your assets to a child who owns assets nearing \$5,000,000, leaving his inheritance in a trust could save your grandchildren from paying Federal Estate Tax on the trust upon your child's death.

- **To Guarantee Ultimate Distribution to Beneficiaries of Your Choice.** Trusts can ensure that your assets ultimately pass to beneficiaries of your choice. For couples with children, if one spouse passes, it is possible that the surviving spouse would remarry. A trust for the surviving spouse and the children can be used to keep the deceased spouse's assets segregated from the assets accumulated with the new spouse, and thereby ensure that any balance of those assets remaining at the death of the surviving spouse pass to the couple's children. Similarly, you could specify in trusts for your children that the trust assets remaining at your child's death pass to your grandchildren or your other children. Also, future changes in circumstance, such as diminished capacity due to age or undue influence from others, might arise during the lifetime of your beneficiary, and could result in changes to the estate plan. Trusts can be used to protect the assets from these circumstances.

- **To Set Limitations or Guidelines for Distributions to a Beneficiary.** Trust provisions can be customized to suit your particular situation. For example, if you are concerned about the assets in the trust lasting for the long-term, you can appoint a trusted third-party to be the trustee. You may wish to specify that a particular amount of money or a certain percentage of the trust be distributed automatically to the beneficiary on a monthly basis. Trusts can also provide that distributions may be made only for certain purposes, such as medical care or education.

- **To Hold Real Estate for Multiple Beneficiaries.** If you have real estate that you wish to pass to multiple members of your family, but are concerned that the responsibilities, costs, and use may create squabbling, you can pass the real estate (and an additional amount for

maintenance and other expenses) to a trust. The trust could specify who is in charge of decision-making, and could set forth guidelines for the use and sharing of expenses.

Trusts cannot be created by the beneficiary without losing many of these benefits. For those of you who expect to receive inheritances in the future, consider receiving the inheritance in trust instead of outright. You should discuss this with the person from whom you may someday receive an inheritance.

Many people have concerns about the ease of administering a trust. However, trust administration does not have to be complicated or expensive. In many cases, a beneficiary can be the trustee of his or her own trust and have significant

control over how the assets are invested and used, and to whom the assets are distributed at death.

### **IRS Proposed Rules about Discounting**

The IRS has recently proposed new regulations which are called Section 2704 Regulations. For taxpayers whose estate exceeds \$5,490,000, the Federal Estate Tax rate on the excess is 40%, and thus it is important to utilize gift planning. The making of gifts while applying discounts on value is a critical estate planning technique. If approved, these Regulations will severely limit taxpayers' ability to make leveraged gifts. If your estate exceeds these amounts, it is important to immediately consider using this discounting technique now rather than waiting.

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### **Medicaid Planning**

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couple can own only about \$120,000. Some assets, such as a personal residence, are not included in this calculation. In addition, no gifts may be made within five years of applying for Medicaid.

One effective Medicaid planning technique is for the client to make gifts at a time when the client is relatively healthy. An optimal gift can be calculated by projecting cash flow over five years with expected income and an assumed amount of expenses. It is important for the person to keep sufficient assets to last during this period. Applying for Medicaid during the five-year period would trigger a penalty period of ineligibility. If the client depleted his or her assets prior to the expiration of the five-year period, it is critical to seek professional advice on when it would be best to make a Medicaid application.

If actual expenses turn out to be greater than estimated, the client's money could run out in less than five years. In this case, the client would need to rely on family to pay for the cost of care during the five-year period or during the penalty period of ineligibility, or all of the gift would need to be repaid in order to be eligible for Medicaid.

The gift can be made to a trust rather than outright. If the gift were made outright to individuals, it is more likely to be comingled with the individuals' other assets. An outright gift is also potentially subject to the claims of the individuals' creditors and equitable distribution. A gift to a trust can prevent these issues. However, in no event can the client making the gift have a right to receive any benefits from the trust.

During the five-year period leading up to the Medicaid application, it is critical to maintain detailed financial records. We recommend that clients who anticipate applying for Medicaid keep paper copies of all financial statements plus canceled checks and invoices for any expenses over \$1,000 during this period. If the time comes to apply for Medicaid, this information will be required and

the application process will be greatly expedited if this information is easily accessible at that time.

### **Guardianships and SNTs**

In 2016, the Centers for Disease Control's Autism and Developmental Disabilities Monitoring reported that approximately 1 in 68 children in the United States has been identified with an Autism Spectrum Disorder (ASD). The estate planning process requires special consideration when a child or other beneficiary is identified with ASD or other special needs or disabilities.

As a preliminary matter, it is essential that the parent or other family member or friend be appointed as the guardian for the person with special needs. This process requires the filing of a complaint with the Superior Court, including affidavits from two physicians. The Court will require that the alleged incapacitated person be represented by an attorney *ad litem*.

If the Court deems it is in the best interests of the alleged incapacitated person, then that person is adjudicated incapacitated and a guardian is appointed. This process is best completed on or about the person's 18<sup>th</sup> birthday, but it can be done at any time afterward.

The parent's estate planning documents should be coordinated with the guardianship and the child's special needs. First, the parent's estate plan should appoint a substitute guardian if the guardian named in a court proceeding is unable to serve. Second, any assets passing to the child should not pass outright, but rather should pass into a Special Needs Trust (SNT). The terms of the SNT would provide that distributions can be made to the beneficiary with special needs in a manner that will supplement, but not supplant, benefits that the child is receiving, such as SSI and Medicaid. These distributions are made completely in the discretion of the Trustee. Thus, it is important to carefully name the trustees and successor trustees who will best carry out the terms and purposes of the trust.

New Jersey Estate Tax for 2017	
Estate Size	Tax Amount
\$0-\$2,000,000	0
\$2,000,000-\$2,100,000	\$0 plus 7.2% of the amount over \$2,000,000
\$2,100,000-\$2,600,000	\$7,200 plus 8.0% of the amount over \$2,100,000
\$2,600,000-\$3,100,000	\$47,200 plus 8.8% of the amount over \$2,600,000
\$3,100,000-\$3,600,000	\$91,200 plus 9.6% of the amount over \$3,100,000
\$3,600,000-\$4,100,000	\$139,200 plus 10.4% of the amount over \$3,600,000
\$4,100,000-\$5,100,000	\$191,200 plus 11.2% of the amount over \$4,100,000
\$5,100,000-\$6,100,000	\$303,200 plus 12.0% of the amount over \$5,100,000
\$6,100,000-\$7,100,000	\$423,200 plus 12.8% of the amount over \$6,100,000
\$7,100,000-\$8,100,000	\$551,200 plus 13.6% of the amount over \$7,100,000
\$8,100,000-\$9,100,000	\$687,200 plus 14.4% of the amount over \$8,100,000
\$9,100,000-\$10,100,000	\$831,200 plus 15.2% of the amount over \$9,100,000
\$10,100,000-And above	\$983,200 plus 16.0% of the amount over \$10,100,000

New Jersey Inheritance Tax	
Class of Beneficiary	Tax Rate
Class "A": spouse, domestic partner, descendant, parent, step-child, mutually-acknowledged child	Fully exempt
Class "C": sibling, son/daughter-in-law	First \$25,000 - fully exempt Next \$1,075,000 - 11% Next \$300,000 - 13% Next \$300,000 - 14% Over \$1,700,000 - 16%
Class "D": any beneficiary who does not qualify as Class "A", "C", or "E"	If under \$500 - fully exempt If over \$500, first \$700,000 - 15% Over \$700,000 - 16%
Class "E": Charities and other exempt entities.	Fully exempt

Pennsylvania Inheritance Tax	
Class of Beneficiary	Tax Rate
Spouse	Exempt
Descendants & Lineal Heirs	4.5%
Siblings	12.0%
Other heirs, except charities and governmental entities which are exempt	15.0%

Single Life Table Exerpt (for RMD for Inherited IRA)					
Age	Distribution Percentage	Age	Distribution Percentage	Age	Distribution Percentage
37	2.15%	55	3.38%	73	6.76%
38	2.19%	56	3.48%	74	7.09%
39	2.24%	57	3.58%	75	7.46%
40	2.29%	58	3.70%	76	7.87%
41	2.34%	59	3.83%	77	8.26%
42	2.40%	60	3.97%	78	8.77%
43	2.46%	61	4.10%	79	9.26%
44	2.51%	62	4.26%	80	9.80%
45	2.58%	63	4.41%	81	10.31%
46	2.64%	64	4.59%	82	10.99%
47	2.70%	65	4.76%	83	11.63%
48	2.78%	66	4.95%	84	12.35%
49	2.85%	67	5.15%	85	13.16%
50	2.92%	68	5.38%	86	14.08%
51	3.00%	69	5.62%	87	14.93%
52	3.10%	70	5.88%	88	15.87%
53	3.18%	71	6.13%	89	16.95%
54	3.28%	72	6.45%	90	18.18%

Uniform Lifetime Table (for RMD for IRA Owners)					
Age	Distribution Percentage	Age	Distribution Percentage	Age	Distribution Percentage
70	3.65%	80	5.35%	90	8.77%
71	3.77%	81	5.59%	91	9.26%
72	3.91%	82	5.85%	92	9.80%
73	4.05%	83	6.13%	93	10.42%
74	4.20%	84	6.45%	94	10.99%
75	4.37%	85	6.76%	95	11.63%
76	4.55%	86	7.09%	96	12.35%
77	4.72%	87	7.46%	97	13.16%
78	4.93%	88	7.87%	98	14.08%
79	5.13%	89	8.33%	99	14.93%

New Jersey Retirement Income Exclusion			
Year	Married, Joint	Married, Sep	Individual
2016	20,000	10,000	15,000
2017	40,000	20,000	30,000
2018	60,000	30,000	45,000
2019	80,000	40,000	60,000
2020+	100,000	50,000	75,000

Federal Estate Tax Exemption Rates		
Year	Exemption	Max. Tax Rate
2016	\$5,450,000	40%
2017	\$5,490,000	40%

Federal Income Tax Rates							
Income Tax Rate	Single		Married, Filing Jointly		Estates and Trusts		LT Cap. Gains Tax Rate
	2016 Taxable Income	2017 Taxable Income	2016 Taxable Income	2017 Taxable Income	2016 Taxable Income	2017 Taxable Income	
10%	\$0-9,275	\$0-9,325	\$0-18,550	\$0-18,650	---	---	0%
15%	\$9,276-37,650	\$9,326-37,950	\$18,551-75,300	\$18,651-75,900	\$0-2,550	\$0-2,550	0%
25%	\$37,651-91,150	\$37,951-91,900	\$75,301-151,900	\$75,901-153,100	\$2,551-5,950	\$2,551-6,000	15%
28%	\$91,151-190,150	\$91,901-191,650	\$151,901-231,450	\$153,101-233,350	\$5,951-9,050	\$6,001-9,150	15%
33%	\$190,151-413,350	\$191,651-416,700	\$231,451-413,350	\$233,351-416,700	\$9,051-12,400	\$9,151-12,500	15%
35%	\$413,351-415,050	\$416,701-418,400	\$413,351-466,950	\$416,701-470,700	---	---	15%
39.6%	Above \$415,050	Above \$418,400	Above \$466,950	Above \$470,700	Above \$12,400	Above \$12,500	20%
Individuals will owe an additional 3.8% on net investment income if their modified adjusted gross income is over the following thresholds							
	\$200,000	\$200,000	\$250,000	\$250,000	\$12,300	\$12,300	