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
October, 1997

Highlights of Tax Payer Relief Act Of 1997

The new tax law contains some significant changes. Following are brief summaries *of some of these provisions. Further review is advisable to determine how these would apply in your personal circumstances*.

Capital Gains

The tax rate is 20% on gains for sales after May 7, 1997, which is significantly lower than the prior rate of 28% (the rate is 10% for taxpayers who are in lower tax brackets); but, now *assets must be held for at least 18 months*, as compared to 12 months previously. Gains on collectibles, such as artwork, coins, etc., don't qualify at all for the new rates. Also, if you sell real estate, the gain will be taxed at 25% to the extent that you had taken depreciation.

Federal Estate Tax Exemption

The current "estate tax exemption" of $600,000 is increased, in stages, to be as follows:

1998..........................$625,000

2002-2003..................$700,000

1999..........................$650,000

2004..........................$850,000

2000-2001..................$675,000

2005..........................$950,000

2006 and later............$1,000,000

This is *not* a great increase in the exemption, considering inflation and the cost of living. *It's still very important to have a Will which utilizes a "by-pass trust" as a part of your estate plan, if your total assets (including all real estate, retirement accounts, stock portfolios, bank accounts, life insurance, etc.) are greater than $600,000. This advance planning is necessary to be able to utilize both spouses' exemptions, and to thereby pass $1,200,000 in an estate tax-free manner to your family.*

Sale of Principal Residence

Effective May 7, 1997, there is an exclusion of $500,000 on the sale of a personal residence for those filing a joint return ($250,000 if you're single). This is available to all taxpayers (regardless of age), and can be used once every two years. The home must have been used as your principal residence for at least two of the last five years, in order to qualify... There are complexities: be careful if your spouse used the exclusion shortly before your marriage; you must still consider prior tax-free rollovers in computing your gain; there are exceptions for "unforeseen circumstances"; etc.

Individual Retirement Accounts

The new "Roth IRA" allows individuals to make *nondeductible* contributions of up to $2,000 of compensation; and *all future withdrawals* will be *completely tax-free*; the withdrawal can't be taken within five years of your first contribution, and can be taken only after age 59½, or upon death, disability or to pay up to $10,000 for first-time homebuyer's expenses. The "Roth IRA" isn't available if your income is over $110,000 for single-filers, and $160,000 for joint filers.

You can *roll-over* your existing IRA to a Roth IRA. Regular income taxes will be due on the amount that you roll-over, but the 10% early distribution penalty doesn't apply. If the roll-over is made prior to December 31, 1998, you can pay the tax due over four years. But, if your income is over $100,000, you're *not* eligible for such a roll-over.

The traditional deductible IRA has changed slightly. A spouse can now contribute $2,000 of compensation, *even if* the other spouse participates in a plan. The deduction is not allowed, however, for joint filers with more than $160,000 in income.

If your income is less than $100,000, then you should give consideration to converting your existing IRA to a Roth IRA. Although you would have to pay income taxes currently, the 10% penalty does not apply, and the benefit of later withdrawing all of the income tax-free will be great, especially if you'll be able to leave the Roth IRA to grow for an extended period of time until you retire.

Repeal of Excess Distribution/Accumulation Taxes

The 15% excise tax on "excess distribution" during lifetime and "excess accumulation" at death, on retirement plan assets, has been *entirely repealed*! There had been in place a three-year moratorium on this excise tax. *This repeal illustrates the dangers of relying on current tax law!*

Family Business Exclusion

If more than 50% of your estate is made up of a qualified family-owned business, your executor may exclude up to $1.3 million of the business' value from the taxable estate. But, essentially, the additional exclusion is only the *difference* between your "regular" estate tax exemption and the $1.3 million. So, in effect, the business exclusion is only $675,000 in 1998 (when the regular exemption will be $625,000), and the exclusion gradually declines to only $300,000 in 2006 (because the regular estate tax exemption will then be $1 million). If your estate "fits" this size range, the potential estate tax savings can be extremely significant. However, the requirements to qualify, including family participation in the business, are strict; and there will be a "recapture" if the rules are not met for ten years after death.

Annual Exclusion Gifts

This is a reminder to take advantage, before December 31, of the $10,000 per donee per year gift tax exclusion (which is $20,000 per donee per year if you're married). The new law provides "inflation adjustments" to the amount of this exclusion, but the first adjustment won't be until 1999 or thereafter.

Also, one of the new laws is to "fix" the statute of limitations on gifts at three years (unlike under prior law, when the IRS could in effect extend the statute of limitations on gifts); but one of the requirements is that the gift must be adequately disclosed on a gift tax return. This makes it more important than ever to file a gift tax return each year, especially for gifts of an interest in a family corporation or a family partnership.

FYI:

The top 1% of earners paid 30.2% of the total income taxes paid (in 1995); and the top 5% paid 47% of the total income taxes paid (in 1994); and the top 50% paid 95% of the total income taxes paid (in 1994).