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, 2000

Estate Planning Ideas for Year-End

The Year 2000 is fast coming to a close, and this is to remind you that it may be advisable to take certain estate planning steps before December 31st. The following are some estate planning techniques and related ideas to be considered.

1. **Estate Tax "Exemption"**. This remains at $675,000 for the year 2001. Following is a schedule which indicates what the exemption amount will be (under current law) for the next few years:

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

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

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

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

2006 and thereafter.........$1,000,000

The estate tax begins at 37% (on assets over $675,000) and reaches 55% (on taxable estates of $3,000,000).

2. **Unified Gift and Estate Tax System**. It is not possible to eliminate estate taxes simply by gifting away your assets because the Gift Tax rates are essentially the same as the Estate Tax rates. However, there are numerous estate planning techniques which can be used to reduce Estate Taxes. Utilization of "valuation-discounting" is currently a very significant factor to be used in estate tax planning.

3. **Annual Exclusion**. You may make gifts of $10,000 per donee per calendar year, without paying any gift taxes and without using any part of your lifetime estate exemption. If you are married, the $10,000 exemption is effectively doubled to $20,000. If you make a gift by check, it is important that the check clear your account by December 31st. Certain gifts to Trusts will not qualify for the annual exclusion.

4. **Non-Tax Estate Planning**. This is also extremely significant. It is important that your Will and estate plan be implemented, so that your assets will pass to your intended beneficiaries, in the amounts and percentages, and under the appropriate terms, as intended. It is important that you provide protection for your children by using Trusts as may be appropriate; and it is important that you name the Executor and Trustee and Guardian of your choice.

5. **Utilizing Both Spouses' Exemptions**. If you are married, and if you were to leave all of your assets to your spouse, the net effect is that your $675,000 exemption would be wasted. Rather than leaving all of the assets to your surviving spouse, you can bequeath part of your assets to a Trust for your surviving spouse. Your surviving spouse can have the use and benefit of the Trust assets. This Trust is also

known as a Credit Shelter Trust, and is also sometimes called a Marital Trust. The net effect is that your heirs would receive the amount of $1,350,000 on a tax-free basis, rather than receiving only $675,000 on a tax-free basis. This would result in an estate tax reduction of about $270,000-$370,000. This technique is highly advisable for any couple with assets over $675,000.

6. **Living Trusts**. There has been much publicity about Living Trusts, touting ostensibly great advantages. Frequently, these advantages are over-stated, but, generally, the Living Trust is a useful estate planning tool. It is advisable to include a Living Trust as part of your estate plan, whether or not you actually currently fund the Living Trust. It is especially advisable to use a Revocable Living Trust for any out-of-state assets which you may own.

7. **Power of Attorney**. It is advisable that you sign a Power of Attorney, granting to your spouse or some other trusted person, the power to handle your affairs in the event that you were to become incapacitated. If needed, this would prevent an otherwise expensive and time-consuming guardianship. The Power of Attorney can be worded to take effect only in the event that you were to become incapacitated.

8. **Titling of Assets**. It is extremely important that your assets be titled in a manner which is coordinated with your overall estate plan. It is common to hold assets in joint names, but holding too many assets in joint ownership could have the effect of defeating the intended estate plan and causing unnecessarily high estate taxes for your heirs. It is important to review this matter of titling, periodically, as your estate grows.

9. **Gifts for Tuition and Medical Expenses**. In addition to the $10,000 Annual Exclusion, and the $675,000 Exemption, and the Martial Deduction, you may also make tax-free gifts by way of paying tuition and medical expenses for your family members. For example, if you were to pay a $25,000 tuition payment for your grandchild, that would be gift-tax free, and would not use up any part of your annual $10,000 exclusion. It is important to note that any such tuition and medical payments must be made directly to the provider.

10. **Family Limited Partnership (FLP)**. This remains to be a very viable technique to consolidate assets, and also to serve as a means of making gifts to your family members in a leveraged manner. Generally, leverage is obtained, because by gifting a non-voting interest the value can be discounted for gift tax purposes. For example, for a partnership which has $1,000,000 in total value, a 20% interest might be deemed to have a value of only $120,000 for gift tax purposes, by virtue of allowable discounts in valuation. Also, it is possible to give away a majority of the equity for purposes of reducing your taxable estate, and still retain control so long as you hold only the voting shares, which may represent as little as 1% of the total equity. Sometimes, a Limited Liability Company (LLC) is used in place of a FLP.

11. **Qualified Personal Residence Trust (QPRT)**. This is also a very favorable technique, which allows you to give away your house at a discounted value. You can retain the right to the full use and benefit of the house for a certain number of years, and provide that your children would receive the house when that term of years has expired. The potentially high estate tax on your house can be very significantly reduced.

12. **Grantor Retained Annuity Trust (GRAT) and Intentionally Defective Grantor Trust (IDGT)**. These are techniques by which you can retain for yourself the current value of certain assets which you currently own, and transfer to your family only the future appreciation with respect to those assets. For example, you could transfer $500,000 into a GRAT or an IDGT, and provide that you would receive back the $500,000 plus a yield of 7% over a period of, say, 5 years. If the property were to grow at a rate higher than the 7%, the excess will accumulate in the Trust, and will in effect be transferred free of any gift taxes to your children.

13. **Charitable Remainder Trust (CRT)**. This is a means to place assets into a Trust, and retain the right to income from the Trust for a number of years, and obtain a current charitable

deduction for income tax purposes. The remainder passes to the charity(ies) of your choice, which can be subsequently changed, when the stated number of years expires.

14. **Irrevocable Life Insurance Trust (ILIT)**. As a general rule, the face amount of life insurance is taxed as part of your estate. For example, without proper planning, the estate tax on a $1,000,000 life insurance policy could be $550,000. It is generally advisable to use an ILIT, in order to remove the insurance from being taxed as part of your estate.

15. **IRA and Pension Planning**. It is important to note that retirement plan assets are subject to both estate tax and income tax. For example, the estate tax might be 50%, and the remaining amount would then be taxed as ordinary income (at, say, a 33% rate) to the beneficiary. It is very important that detailed attention be given to both the estate tax planning and income tax planning for your retirement accounts.

16. **Required Minimum Distributions From Your IRA**. It is extremely important that you make the best election for the payout of your IRA. The payout election becomes irrevocable on April 1 of the year after that in which you reach age 70½. If you do not affirmatively make an election, there will be an election by default.

17. **Roth IRA**. This is a type of IRA which compounds on a totally tax-free (not merely tax-deferred) basis. It is possible to convert your traditional IRA into a Roth IRA; and this can result in very significant long-term benefits to your family members. You can convert your existing IRA into a Roth IRA, but only in a year when your annual income is less than $100,000.

18. **IRA for Your Child**. One advantageous method of making gifts to your children, would be to fund an IRA for your child (either a traditional or Roth IRA).

19. **Generation-Skipping Transfer (GST) Tax**. If you leave assets to your children, it is likely that your grandchildren will ultimately pay estate taxes on your children's estate. You can leave assets to trusts for your children and grandchildren, and thereby by-pass the estate tax at the generational level of your children, but this constitutes a GST which is potentially subject to a 55% tax (in addition to the normal estate tax of 55%). However, every individual has a $1,030,000 GST exemption. It is important to properly utilize this GST exemption, by having the appropriate provisions in your Will.

20. **Reverse Mortgage**. One method of providing cash flow to elderly parents might be for the children to make monthly payments to the parents, in the form of a "reverse mortgage loan". As each monthly payment is made, the child's loan is secured by a mortgage on the home. A parent might want to make large gifts to children; the parent would lose the income from the gifted property, but the reverse mortgage arrangement could provide replacement cash flow to the parent to meet his/her daily needs, while continually reducing the net equity owned by the parent by virtue of the mortgage held by the child.

Some Interesting Tax Facts:

If you had gross income of about $270,000 or more, in 1998 you ranked in the top 1%. The top 5% had income of $114,000 or more.

The top 1% of taxpayers pays about 35% of all Federal Personal Income Taxes, and the top 5% pay about 54% of the total Personal Income Taxes.

The lower 50% of taxpayers pay about 4% of the total Federal Personal Income Taxes.