

LAW OFFICES
BERNETICH, HATZELL & PASCU, LLC

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

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

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

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

WEBSITE: WWW.ESTATEPLANLAWYER.COM

CLIENT MEMORANDUM
December, 2007

◆ **Current Estate Tax Rates.**

1. Federal Estate Tax

Year	Exemption	Tax Rate
2007	\$2,000,000	45%
2008	\$2,000,000	45%
2009	\$3,500,000	45%
2010	no estate tax this year	
2011 & after	\$1,000,000	55% (max.)

will expire at the end of 2010. In the absence of new legislation, in 2011 we will revert to the prior Estate Tax law. It appears unlikely that there will be any change in the law prior to the presidential election in November 2008. And any change which may occur thereafter will depend on who is elected President and whether the Republicans or the Democrats control Congress. At this point, no one knows what will happen...we shall see...

2. New Jersey Estate Tax

Amounts	Effective Tax Rate
\$0-\$675,000	0%
\$675,000-\$727,175	37.0% *
\$727,175-\$900,000	4.8%
\$900,000-\$1,100,000	5.6%
\$1,100,000-\$1,600,000	6.4%
\$1,600,000-\$2,100,000	7.2%
\$2,100,000-\$2,600,000	8.0%
\$2,600,000-\$3,100,000	8.8%
\$3,100,000-\$3,600,000	9.6%
\$3,600,000-\$4,100,000	10.4%
\$4,100,000-\$5,100,000	11.2%
\$5,100,000-\$6,100,000	12.0%
\$6,100,000-\$7,100,000	12.8%
\$7,100,000-\$8,100,000	13.6%
\$8,100,000-\$9,100,000	14.4%
\$9,100,000-\$10,100,000	15.2%
\$10,100,000-And above	16.0%

* Note: the benefit of the exemption is lost if the estate exceeds \$675,000

◆ **A Married Couple has Two Estate Tax Exemptions.**

It is important that the available estate tax exemptions of *both* spouses be utilized. If a husband leaves his entire estate to his spouse, then the children would receive the benefit of only the wife's exemption. Proper planning is needed for your children to receive the benefit of *both* exemptions.

This is usually accomplished by using a "By-Pass Trust". The husband would leave part of his estate to a trust *for the benefit of* the surviving spouse, so that those assets will not be taxed in her estate.

Using a "disclaimer" type of By-Pass Trust often provides maximum flexibility.

In order for this type of plan to be implemented, it is appropriate for each spouse to own half of the assets. As a general rule, having assets in joint names

3. The current Federal Estate Tax law, with the exemptions as stated above,

will result in the children's paying more Estate Taxes.

Also, beneficiary designations on life insurance and retirement plans must be coordinated with the overall plan involving a By-Pass Trust. For example, even if a By-Pass Trust is provided in your Will, if the surviving spouse is the beneficiary of the life insurance and retirement plans then possibly no assets would pass to the By-Pass Trust. The result could be unnecessarily high Estate Taxes being paid by the children.

- ◆ **Generation-Skipping Transfer (GST) Trust for Future Inheritances.** Any assets which you receive by gift or bequest from your parents (or from any other person) will increase the size of your estate and thus ultimately be taxed as part of your estate. The Estate Tax rate payable by your children might be 50%.

It would be better if your parents leave assets to a By-Pass Trust *for* your benefit. You can be the Trustee of the Trust, have very broad powers to make withdrawals from the Trust for the benefit of yourself and your family, and direct where the assets would pass upon your death, without causing the assets to be taxed as part of your estate. The potential Estate Tax savings is very significant.

In order to utilize this technique, it is necessary that your parents make the bequest to the Trust for you. Under the Estate Tax laws, you cannot first receive the assets and then place them into such a Trust for your own benefit.

Also, if you were to receive those assets outright, then these assets would be subject to your creditors and other such claims.

The same concept applies when you bequeath assets to your children. If you direct assets into a GST Trust for the

benefit of your children, then this would accomplish estate planning for your children which planning your children could not effect for themselves if they were to have received the assets outright.

If the assets are placed in such a Trust, they are more likely to be protected from claims of general creditors and from claims of a spouse in the event of a divorce.

- ◆ **QTIP Trust.** Especially in the case of a second marriage situation, you may wish to provide that your spouse have the use and benefit of assets for lifetime, but further provide that any remaining assets should pass to your children from your first marriage at the time of the death of your surviving spouse. A Marital QTIP Trust is frequently utilized for this purpose. It can be very broad or very restrictive, depending on your wishes.
- ◆ **Medicaid Planning.** When drafting your Will, it is important to consider whether your beneficiary is qualifying for any Medicaid benefits. If you bequeath assets to your child, then he or she may lose qualification for such benefits. On the other hand, if assets are bequeathed to a properly drafted Trust for that child, then your child would still qualify for Medicaid.
- ◆ **Review of Estate Plan Documents.** There are various reasons for having your estate plan documents reviewed periodically to ensure that they satisfy your current intentions.

Change in Circumstances. If your family circumstances have changed, such as by a divorce, death of a beneficiary, birth of a child, or a substantial increase in the size of your estate, then your estate plan should be reviewed.

Change in Law. Federal and state estate tax laws change from time to time. These

changes could have a significant affect on your estate plan.

The New Jersey Estate Tax laws were changed in 2001. If your Will was drafted prior to that time, then your estate could be subject to more estate tax than is necessary. It is especially important to review your Wills if they were drafted before 2001.

Beneficiary Designations. It is important that you review the beneficiary designations of your retirement plans and of your life insurance, so as to make sure that the designations are properly coordinated with your overall estate plan. Beneficiary designations on any retirement accounts opened after your estate planning documents have been prepared are not always consistent with your plan. This is also true of beneficiary designations on newer life insurance policies.

Titling of Assets. It is important that the titling of your assets be reviewed. Generally, spouses should not have all of your assets in joint names. It is usually better for each of husband and wife to have separate individual accounts, in order to better effect the desired estate planning. As new assets are acquired, the titling should be coordinated with your estate plan.

Periodic Review. It is prudent in any event to review your estate plan approximately every three years.

- ◆ **Power of Attorney.** It is important to have in place a Power of Attorney, which grants to another individual the power to handle your financial affairs in the event that you were incapacitated. There have been a few changes in the laws regarding Powers of Attorney in the last few years, and, even if you have a Power of Attorney, this should be periodically

reviewed and updated.

- ◆ **Gifting.** The annual gift tax exclusion is \$12,000 per person per year. If you are married, then this exemption is effectively doubled to \$24,000 per person per year. For example, if you have three children, and if each has a spouse and three children, then the total number of potential beneficiaries is 15. If you were to fully utilize the \$24,000 exclusion for each of those 15 beneficiaries, then the amount which can be gifted in each calendar year without any gift or estate tax consequences is \$360,000.
- ◆ **Section 529 College Savings Plans.** You can make a contribution to a Section 529 Plan, and all future withdrawals would be exempt from income tax so long as the distributions are used for "qualified higher education expenses". You can use five years' worth of annual gift tax exclusion when gifts are made to a Section 529 Plan in a single year. The Section 529 account is flexible, in that you can change the beneficiary in the future.
- ◆ **Grantor Retained Annuity Trust (GRAT).** You can transfer assets into a Trust, and you can receive your assets back in the form of an annuity over two or three years at a relatively low interest rate. Essentially, you would be transferring all of the appreciation thereon to your children without any gift tax consequences. If you have already utilized your lifetime gift tax exemption, this technique is particularly appealing.
- ◆ **Family Partnerships.** Family Partnerships (and Limited Liability Companies) are an effective means of transferring assets to your children and grandchildren at reduced estate and gift tax rates. If you already have in place a Family Partnership, it is important that proper books and records be kept, and that the legal formalities are complied with.

◆ **Qualified Personal Residence Trust (QPRT)**. This is an Irrevocable Trust which holds title to your principal residence or a vacation home. You transfer the house into a Trust and retain the right to live in the property for a term of, say, 10 or 15 years. When the term expires, the property belongs to your children; you can still live in the house by paying rent to your children. This is a very effective means of transferring your primary home or your vacation home, or both, to your children at significantly reduced gift and estate tax rates.

◆ **Converting a Traditional IRA to a Roth IRA**. A Roth IRA is an IRA which will never be subject to federal income taxes when it is withdrawn. There is no deduction for contributions to the Roth IRA, but the potential benefit of long-term tax-free growth and for ultimate tax-free withdrawal is extremely significant.

Generally, you can convert your traditional IRA to a Roth IRA by paying the income tax on your IRA now. Although this may initially sound like a bad idea, an analysis shows that the long-term benefits can far outweigh the initial costs. After the conversion, all growth within the IRA would be tax-free. Under current law, a conversion is only permissible if your annual income is less than \$100,000; however, effective in 2010, this limitation will not apply. A Roth conversion is an especially appealing technique if you are over age 70 and you do not use your IRA for day-to-day expenses.

◆ **Spousal IRA Rollovers**. If a surviving spouse is the beneficiary of an IRA:

1. This is "good" for income tax purposes, because the surviving spouse can rollover the benefit into a "rollover IRA" and obtain maximum income tax deferral.
2. But, this is "bad" for estate tax purposes, because the IRA would then be taxed as part of the surviving spouse's estate.

On the other hand, if a trust is the beneficiary of an IRA:

1. This is "bad" for income tax purposes, because trusts will usually pay a higher income tax than an individual would.
2. But, this is "good" for estate tax purposes, because all of those funds in the Trust would be excluded from the spouse's taxable estate.

This is a subject which requires specific analysis in your individual circumstances; what is best for one person may not be best for another. Implementing the proper beneficiary designation for your retirement account is an extremely significant aspect of estate planning, especially if your retirement account constitutes a large percentage of your total assets.