

LAW OFFICES
BERNETICH, HATZELL & PASCU, LLC

JOHN D. BERNETICH JR.
 JAMES L. HATZELL*
 PAUL PASCU
 KRISTIN L. EATON
 GRAYSON H. HEBERLEY III**

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
 ** OF COUNSEL

WEBSITE: WWW.ESTATEPLANLAWYER.COM

CLIENT MEMORANDUM
December 5, 2012

Think you cannot protect yourself from the “Fiscal Cliff”?

You have no doubt been hearing about the Fiscal Cliff, the possible changes in our tax laws, and the opportunities to take advantage of the current tax laws before they change in January. Maybe you have been hearing that the only certainty is continued uncertainty, so you have been putting off making changes to your estate plan. Maybe you have been thinking that your estate is not large enough to be affected. The reality is that many people who can greatly benefit from implementing some estate planning techniques have yet to pursue them.

Potential Tax Changes Post-Election

What changes are slated to take place?

Without action from Congress, many of the recently-passed temporary tax cuts will expire, and income tax rates will revert to the previous higher rates. The tables below are for illustration purposes only and reflect 2012 dollar amounts, which may be adjusted for inflation.

Income Tax Brackets – for Single Person			
Taxable Income Over	But Not Over	2012 Marginal Rate	2013 Marginal Rate
\$0	\$8,700	10%	15%
\$8,700	\$35,250	15%	15%
\$35,350	\$85,650	25%	28%
\$85,650	\$178,650	28%	31%
\$178,650	\$388,350	33%	36%
\$388,350		35%	39.6%

Income Tax Brackets – for Married Filing Jointly			
Taxable Income Over	But Not Over	2012 Marginal Rate	2013 Marginal Rate
\$0	\$17,400	10%	15%
\$17,400	\$70,700*	15%	15%
\$70,700*	\$142,700	25%	28%
\$142,700	\$217,450	28%	31%
\$217,450	\$388,350	33%	36%
\$388,350		35%	39.6%

*in 2013, this dollar amount will decrease to 167% of the amount for single filers, resulting in more married filers in the 28% bracket.

Under temporary laws effective for 2011 and 2012, FICA taxes (Social Security and Medicare) withheld from employees’ pay were limited to 4.2% for Social Security and 1.45% for Medicare. That temporary limit will expire in 2013 and employees will again have 6.2% of pay withheld for Social Security. The Medicare Tax is also set to increase. Beginning in 2013, higher wage earners (\$200,000 – single; \$250,000 – joint) will pay an additional Medicare Tax of 0.9% on wages exceeding the threshold; and a new 3.8% Medicare Tax will be imposed on net investment income such as interest, dividends, net capital gain, and income from “passive” trade or business activities. Also, many estates and trusts will be subject to this new Medicare Tax.

Without action from Congress, the maximum capital gains rates on long-term capital gains will rise from 15% to 20%. Additionally, qualified dividends will no longer be

taxed at the capital gains rates and will be taxed as ordinary income.

The Gift Tax and Estate Tax Exemptions are currently \$5.12M per person (\$10.24M for a married couple), but these expire on December 31, 2012. Without any further legislation, on January 1, 2013 the Gift Tax Exemption and Estate Tax Exemption will revert to \$1M and the maximum tax rate will rise to 55%.

The Generation-Skipping Transfer (GST) Tax Exemption is also scheduled to decrease from \$5.12M to \$1.36M.

Portability, which allows a surviving spouse to inherit the unused portion of the Federal Estate Tax exemption from a deceased spouse, is set to expire in 2013.

Other restrictions on estate planning techniques have been proposed.

What might happen?

Whether and when Congress will move out of gridlock and affirmatively make decisions regarding our tax law is an unknown. Below are some possibilities.

- If no new legislation is implemented by January 1, 2013, the above changes will take place. These are significant changes that will impact nearly everyone, regardless of income level.
- If new legislation is implemented by January 1, 2013, it may take one of the following forms:
 - Tax rates might be left as is, but itemized deductions, such as home mortgage interest and charitable contribution deductions may then be restricted.
 - We could have comprehensive tax reform. This likely would take place sometime after the first of the year, if at all.
 - Although changes have been looming now for years, Congress may again “kick the can down the road” for another year or so, simply postponing the decision about what changes to make. That is what happened two years ago.

What Can You Do Now?

Power of Attorney and Living Will

Regardless of what changes in the laws may occur, and regardless of the size of your estate, you should have in place a Power of Attorney and a Living Will (also known as Advance Directive for Health Care and Health Care Proxy). If you have such documents already, take a look at them to make sure they are in line with your current wishes. If you do not have these documents in place, it is time that you do so.

Both the Power of Attorney and Living Will are precautionary documents that would greatly help your loved ones in the event you were to suffer an accident or illness.

A Power of Attorney gives authority to someone you appoint, your Agent, to handle your financial affairs. If you were to become incapacitated for any reason, a Power of Attorney would allow your Agent to smoothly transition into handling your financial responsibilities without the costly, uncomfortable and time-consuming process of guardianship.

A Living Will has two purposes. First, it states your wishes regarding the non-maintenance of artificial life support systems in circumstances involving a terminal condition with no hope of recovery. Secondly, it names a Health Care Representative, which gives that person the legal authority to interpret and carry out your wishes.

Both of these documents are extremely important and should be periodically reviewed.

Titling of Assets and Designations of Beneficiaries

Keep in mind that some assets, such as retirement plans, life insurance, and jointly-owned assets, do not pass through your Will. Therefore, it is important to review each of your assets. Are the beneficiary designations in line with your wishes, and are they properly coordinated with your overall estate plan? Do they allow you to take full advantage of your exemptions? These are issues that should be reviewed periodically. The pending changes in the law make this review even more important.

What Type of Additional Planning Should You Consider?

Having an appropriate Will in place is advisable for everyone, even if the estate taxes are not a major issue. Proper planning is needed to address issues regarding the proper disposition of your estate. For example, a by-pass trust for a spouse or a trust for a child is frequently advisable, for the following reasons:

- (a) to protect the assets from claims of creditors;
- (b) to enable your surviving spouse to qualify for Medicaid;
- (c) to protect assets from claims of your child’s spouse in the event of divorce;
- (d) to provide proper management of assets for beneficiaries, especially for minor and disabled beneficiaries;
- (e) to keep assets from being taxed in your child’s estate; and
- (f) to keep assets from being taxed in your surviving spouse’s taxable estate.

During the past few years, Federal Estate Tax has not been much of a concern for estates in the \$1M to \$5M range. But, effective January, if no legislation is passed, the Federal Estate Tax Exemption will revert to \$1M, and will have an enormous impact on the amount the beneficiaries

of your estate will receive. New Jersey Estate Taxes are also a big factor, regardless of what happens to the Federal Estate Tax law.

Now may be the best time to utilize some other estate planning techniques which may be eliminated by new laws; there have been discussions in the Treasury Department about eliminating certain planning techniques, such as GRATs (Grantor Retained Annuity Trusts), and “discounting” (that is, reducing values for Estate Tax purposes due to minority interest and other lack of marketability reasons).

The potential costs of failing to take advantage of the current planning opportunity could be high. It seems advisable to err on the side of planning somewhat aggressively. Some planning must be completed before December 31, 2012.

Federal Gift Tax

This Gift Tax exemption of \$5.12M provides a very significant (and possibly one-time) opportunity for individuals with large estates to transfer a significant amount of assets (up to \$10.24M for a married couple) without incurring any Gift Tax. Making a gift will also remove from the taxable estate all future appreciation on the gifted asset, and remove all income earned in the future on that asset. Making gifts will also significantly reduce the potential Pennsylvania Inheritance Tax and New Jersey Estate Tax. Without action from Congress, this opportunity will lapse on December 31, 2012.

A potential disadvantage, however, of making a gift, which should be discussed with your estate planner, is the “carry-over of basis” on gifts.

Annual Exclusion

You may make gifts of \$13,000 per donee per calendar year without paying any gift taxes and without using any part of your lifetime estate tax exemption. If you are married, the \$13,000 exemption is effectively doubled to \$26,000. If you make a gift by check, it is important that the check clear your account by December 31st. The annual exclusion is slated to rise to \$14,000 in 2013. Certain gifts to Trusts will not qualify for the annual exclusion.

Gifts for Tuition and Medical Expenses

In addition to the \$13,000 Annual Exclusion, 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 \$35,000 tuition payment for your grandchild, that would be gift tax free, and would not use up any part of your annual \$13,000 exclusion. It is important to note that any such tuition and medical payments must be made directly to the provider.

Section 529 College Savings Plans

You can make a contribution to a Section 529 Plan, allow the investment to grow, 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.

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. Low real estate values make this technique relatively more attractive.

Gifting to Trusts

Make gifts to trusts, not directly to heirs. Trusts provide protection from creditors, from a divorcing spouse, and from estate taxation on future generations (i.e., trusts can keep the assets out of your children’s and even your grandchildren’s estates).

Trusts can be structured as “grantor trusts” so you can sell assets to them without triggering capital gains. When a trust is established to be a grantor trust you can pay the income tax on trust income thereby growing the value of the assets inside the trust faster while shrinking the taxable assets left in your name. Such payment of the income tax would in effect be a tax-free gift to your children. Many of these benefits are on IRS’s list of “loopholes” it hopes to close. So, these are benefits you might want to try to secure now, so that they will be respected even if the law changes in the future (they may be “grandfathered”).

Selling to Trusts

Depending on the size of your estate, the type of trust you might opt to use, your family considerations, and a host of other factors, it may be beneficial for you to sell some assets to a trust, instead of merely giving them to the trust. This type of plan would allow you to transfer any future appreciation in value, to your heirs, while retaining for yourself the value of your current principal.

Taxes to Consider in Estate Planning

Pennsylvania Inheritance Tax

Class of Beneficiary	Tax Rate
Spouse	exempt
Descendants	4.5%
Siblings	12%
Other heirs; except charities and governmental entities which are exempt.	15%

Federal Estate Tax

Year	Exemption	Maximum Tax Rate
1987-1997	\$600,000	55%
1998	\$625,000	55%
1999	\$650,000	55%
2000-2001	\$675,000	55%
2002	\$1,000,000	50%
2003	\$1,000,000	49%
2004	\$1,500,000	48%
2005	\$1,500,000	47%
2006	\$2,000,000	46%
2007-2008	\$2,000,000	45%
2009	\$3,500,000	45%
2010	NO ESTATE TAX	N/A
2011	\$5,000,000	35%
2012	\$5,120,000	35%
2013	\$1,000,000	55%

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, and this higher effective rate constitutes a make-up rate.

There is no portability of the \$675,000 exemption. This means that, if the pre-deceasing spouse's exemption is not utilized by proper planning, then the exemption is lost, which would result in an unnecessarily high Estate Tax on the "second estate." Thus, a "by-pass trust" (also known as a "credit shelter trust") is still advisable for New Jersey Estate Tax purposes. Also, it may be advisable, in some situations, to have a by-pass trust of more than \$675,000; this may result in some New Jersey Estate Taxes being payable on the first estate, thereby resulting in a much greater overall tax savings at the time of the death of the survivor spouse. Whether such planning is advisable, must be evaluated on a case-by-case basis.

New Jersey Inheritance Tax

Class of Beneficiary	Tax Rate
Class "A": spouse, child, grandchild, parent, step-child, domestic partner, mutually-acknowledged child, etc.	Fully exempt.
Class "C": sibling, son/daughter-in-law, etc.	First \$25,000: fully exempt. On excess: 11% - 16%.
Class "D": any transferee, distributee, or beneficiary who does not qualify as Class "A", "C", or "E"	Under \$500: fully exempt. Otherwise, 15%; and on any amount in excess of \$700,000: 16%.
Class "E": charities, State of N.J., etc.	Fully exempt.

Note: The amount of N.J. Inheritance Tax is credited against the N.J. Estate Tax. (There is no Class "B".)

Required Minimum Distributions (RMD) from Your IRA

The amount of the RMD (in most cases) is computed by dividing the "distribution period" into the value of your account on December 31 of the prior year.

Uniform Lifetime Table			
Participant's Age at end of year	Distribution Period	Participant's Age at end of year	Distribution Period
70	27.4	85	14.8
71	26.5	86	14.1
72	25.6	87	13.4
73	24.7	88	12.7
74	23.8	89	12.0
75	22.9	90	11.4
76	22.0	91	10.8
77	21.2	92	10.2
78	20.3	93	9.6
79	19.5	94	9.1
80	18.7	95	8.6
81	17.9	96	8.1
82	17.1	97	7.6
83	16.3	98	7.1
84	15.5	99	6.7

Note: For example, if the IRA is \$500,000, then the RMD for the year at age 75 is \$21,834 (that is, \$500,000 ÷ 22.9). These rules dictate only the required "minimum" distribution. A participant is always free to withdraw more than the RMD.

STAY TUNED! The tax laws are in a state of flux as this letter goes to print.

We are pleased to welcome our new attorney associate, Kristin L. Eaton.

Also, please check out our newly-updated website.

HAPPY HOLIDAYS !!