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Estate Planning and Recent Tax Developments Year-End Review

FEDERAL ESTATE TAX (FET)

After 12 years of uncertainty regarding the FET exemption, the American Taxpayer Relief Act of 2012 (ATRA) was enacted as a permanent law in January, 2013. From an Estate Tax standpoint, ATRA is a generous change for taxpayers. Very few Estates will owe FET, and most Returns filed will only be for "portability" for surviving spouses.

- **FET Exemption.** The FET exemption for 2013 is \$5.25 million. This is indexed for inflation, and the exemption for 2014 is \$5.34 million.
- **FET Rate.** The maximum FET rate is now 40%.

Federal Estate Tax Exemption Amounts and Rates

Year	Exemption	Maximum Tax Rate
2010	NO ESTATE TAX	N/A
2011	\$5,000,000	35%
2012	\$5,120,000	35%
2013	\$5,250,000	40%
2014	\$5,340,000	40%

- **Federal Gift Tax (FGT) Exemption.** Under the prior law, the FGT Exemption was \$1.0 million. Now, the FGT Exemption is the same as the FET Exemption.
- **Marital Deduction.** All assets passing to a surviving spouse remain free of Estate Tax.
- **Portability of the Exemption.** Under prior law, if all assets were bequeathed to a surviving spouse, the Exemption of the pre-deceased spouse was lost forever.

Now, if the pre-deceasing spouse's Exemption is not utilized, it can be passed along to the surviving spouse. This is called the Deceased Spousal Unused Exclusion (DSUE). This means that if one spouse dies and leaves all assets to the surviving spouse, the surviving spouse will have available an exemption of \$10.5 million (the DSUE of \$5.25 million plus the surviving spouse's own exemption of \$5.25 million).

2014 Tax on Estates

FEDERAL ESTATE TAX

- Exemption Amount: \$5,340,000
- Portability Available for Married Couples

NEW JERSEY

- **Estate Tax** Exemption Amount: \$675,000
- Portability Not Available
- **Inheritance Tax** on Transfers to Anyone Other than a Spouse or Descendants

PENNSYLVANIA

- **Inheritance Tax** on All Transfers to Anyone Other than a Spouse
- No Estate Tax

One qualification is that in order for the surviving spouse to receive the benefit of the DSUE, a FET Return of the pre-deceased spouse must be timely filed. A subsequent marriage of the surviving spouse may cause the DSUE to be lost.

- **Gift Tax Annual Exclusion.** The Annual Exclusion for 2013 is \$14,000. This means that, if you make a gift, the first \$14,000 (if you are married, this figure is \$28,000) is free of any Gift or Estate Tax. Any amount of a gift that exceeds this amount will merely consume part of your FET exemption. For example, if you make a gift of \$50,000 to your child in 2013, the excess over the Annual Exclusion is \$36,000, which will reduce your FET Exemption of \$5.25 million to \$5,214,000. Thus, as a practical matter, the annual exclusion of \$14,000 is no longer a factor if your estate is less than \$5.25 million.

NEW JERSEY & PENNSYLVANIA DEATH TAXES

New Jersey has a much lower Estate Tax Exemption - \$675,000. Currently, no increases are anticipated. The New Jersey Exemption is not indexed for inflation. There is no portability election for New Jersey. The New Jersey Inheritance Tax may also be a factor for some. This Tax would be payable on Estates where the beneficiaries are those other than a spouse or descendants. The Estate

New Jersey Estate Tax	
Estate Size	Tax Amount
\$0-\$675,000	\$0
\$675,000-\$727,175	\$0 plus 37.0% of the amount over \$675,000
\$727,175-\$900,000	\$19,304 plus 4.8% of the amount over \$727,174
\$900,000-\$1,100,000	\$27,600 plus 5.6% of the amount over \$900,000
\$1,100,000-\$1,600,000	\$38,800 plus 6.4% of the amount over \$1,100,000
\$1,600,000-\$2,100,000	\$70,800 plus 7.2% of the amount over \$1,600,000
\$2,100,000-\$2,600,000	\$106,800 plus 8.0% of the amount over \$2,100,000
\$2,600,000-\$3,100,000	\$146,800 plus 8.8% of the amount over \$2,600,000
\$3,100,000-\$3,600,000	\$190,800 plus 9.6% of the amount over \$3,100,000
\$3,600,000-\$4,100,000	\$238,800 plus 10.4% of the amount over \$3,600,000
\$4,100,000-\$5,100,000	\$290,800 plus 11.2% of the amount over \$4,100,000
\$5,100,000-\$6,100,000	\$402,800 plus 12.0% of the amount over \$5,100,000
\$6,100,000-\$7,100,000	\$522,800 plus 12.8% of the amount over \$6,100,000
\$7,100,000-\$8,100,000	\$650,800 plus 13.6% of the amount over \$7,100,000
\$8,100,000-\$9,100,000	\$786,800 plus 14.4% of the amount over \$8,100,000
\$9,100,000-\$10,100,000	\$930,800 plus 15.2% of the amount over \$9,100,000
\$10,100,000 and above	\$1,082,800 plus 16.0% of the amount over \$10,100,000

INCOME TAX AND OTHER ATRA CHANGES

- **Tax on Net Investment Income.** ATRA imposes a new tax of 3.8% on certain types of investment income, including interest, dividends, rents and income from certain passive activities. Net investment income does not include distributions from retirement plans.

Tax is only payable to the extent that it exceeds the Inheritance Tax.

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.

Pennsylvania has an Inheritance Tax payable on transfers to anyone other than a spouse.

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

This means that, for many New Jersey and Pennsylvania residents, estate planning for State Estate and Inheritance Taxes now takes precedence over planning for the Federal Estate Tax. There are many planning options available, depending the value of your assets, age, and family situation. Proper planning is needed to accomplish your desired disposition of assets while minimizing the death taxes your beneficiaries may owe.

New Jersey has no gift tax. Death-bed gifts could result in significant reduction of New Jersey Estate Taxes; but beware of losing step-up in basis when making gifts.

The use of most of the traditional tax planning techniques, such as *By-Pass Trusts*, continue to be appropriate.

This tax only applies if your income is over certain thresholds, which for 2013 generally are:

- \$200,000 for individuals
- \$250,000 for married couples, filing jointly
- \$11,950 for estates and trusts.

- **Ordinary Income Tax Rates.** The maximum rate is increased from 35% to 39.6%.

- **Capital Gains Tax.** Under ATRA, this rate is:
 - 0% for those in the 15% income tax bracket
 - 15% for those in the 25%-35% brackets
 - 20% for those in the 39.6% bracket
- **Medicare Tax.** The Medicare Tax of 0.9% applies to essentially all adjusted gross income over \$250,000 for a married couple and \$200,000 for a single individual.

- **Phase-Out of Certain Deductions.** Certain deductions, such as the deduction for mortgage interest, state taxes, and charitable contributions are phased-out for those essentially with adjusted gross income over \$300,000 for married couples and \$250,000 for a single individual.

Rate	Single		Married, Filing Jointly		Estate and Trusts	
	2013 Taxable Income	2014 Taxable Income	2013 Taxable Income	2014 Taxable Income	2013 Taxable Income	2014 Taxable Income
10%	\$0-8,925	\$0-9,075	\$0-17,850	\$0-18,150	---	---
15%	\$8,926-36,250	\$9,076-36,900	\$17,851-72,500	\$18,151-73,800	\$0-2,450	\$0-2,500
25%	\$36,251-87,850	\$36,901-89,350	\$72,501-146,400	\$73,801-148,850	\$2,451-5,700	\$2,501-5,800
28%	\$87,851-183,250	\$89,351-186,350	\$146,401-223,050	\$148,851-226,850	\$5,701-8,750	\$5,801-8,900
33%	\$183,251-398,350	\$186,351-405,100	\$223,051-398,350	\$226,851-405,100	\$8,751-11,950	\$8,901-12,150
35%	\$398,351-400,000	\$405,101-406,750	\$398,351-450,000	\$405,101-457,600	---	---
39.6%	Above \$400,000	Above \$406,750	Above \$450,000	Above \$457,600	Over \$11,950	Over \$12,150

OTHER ESTATE PLANNING CONSIDERATIONS

- **Same-Sex Marriage.** Previously the Federal Defense of Marriage Act (DOMA) disallowed certain federal tax benefits to same-sex couples. In June of 2013, the U.S. Supreme Court struck down certain provisions of DOMA. As a result, the IRS recently announced a general rule that it will recognize a marriage of same-sex individuals if the marriage was valid in the State where the marriage took place, even if the couple now resides in a State which does not recognize same-sex marriages. The IRS ruling does not apply to domestic partners or civil unions.

Thus, legally married same-sex couples will have the option of filing a joint Income Tax return. And, for Estate and Gift Tax purposes, the marital deduction is now available. Also now, a qualified retirement plan must treat a same-sex spouse as a spouse for purposes of such retirement plan.

- **Step-Up in Cost Basis; Effect of Gifting.** With the advent of the large estate tax exemption, the FET is a lesser consideration. When planning your Will and Trust, and when considering making gifts, relatively more consideration must be given to utilizing the “step-up in cost basis” which is available if the assets are includible in your estate. In some instances, it would be a mistake to give away assets in an attempt to reduce estate tax, because this may cause your heirs to incur a more costly capital gain tax when they sell the gifted assets.

That is, in many cases, highly-appreciated assets should be held until death (rather than being gifted) so that they will receive the step-up in basis.

- **Non-Tax Reasons for a Properly Drafted Will and Trust.**

- Getting the assets properly allocated and distributed to the appropriate beneficiary.
- Planning to *protect your spouse* from claims of creditors, especially if your spouse is in a high-risk profession, and from claims of a new spouse. The recent New Jersey Supreme Court ruling in *Tannen v. Tannen* gave increased legitimacy to discretionary trusts.
- Future estate planning for your children by reducing their estate tax obligations while providing them with access to their inheritances from you, by use of a Generation-Skipping Transfer (GST) Trust.
- Planning to *protect your child* from creditors, and from claims of his or her spouse in the event of divorce.
- Provide for distribution when *beneficiaries reach a more mature age*.
- Allow your child to first obtain his or her own *independence*.
- Avoid *loss of government benefits* for a disabled child.
- Avoiding probate, especially for *out-of-state assets*.
- Allowing for *easier management* of assets in the event of incapacity.
- Planning for the *succession of your business*, and keeping the shares within the desired group of shareholders.

- **Power of Attorney.** It is prudent to have in place a Power of Attorney, so that you have a trusted person who

will be able to step in and manage your affairs in the event that you were to become incapacitated.

- **Life Insurance.** Although life insurance may be necessary for estate tax replacement purposes, there is a new emphasis on using life insurance to obtain income tax free growth.

- **Powers of Appointment.** Use of powers of appointment are important in planning your estate. It may be advisable to use powers of appointment to allow your surviving spouse to re-allocate the ultimate division of your estate among your heirs.

An IRS pronouncement, Chief Counsel Advisory 201208026, concluded that the retention of a testamentary power of appointment makes a transfer in trust incomplete only as to the remainder and not to the lead interest. As a result, the entire transfer is subject to the Gift Tax and must be reported on a Federal Gift Tax Return when the transfer is made, and the balance remaining at death is subject to the Estate Tax and must be reported on a Federal Estate Tax Return.

- **Planning for IRAs and other Retirement Accounts.** If your retirement account is a significant part of your estate, special attention should be given because these accounts are subject to both Income Taxes and Estate Taxes. The availability of extended payments of Inherited IRAs must be considered in order to obtain tax deferral.

See the Uniform Lifetime Table for the Distribution Period for an IRA owner. Please note that a separate table is to be used for owners of Inherited IRAs.

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

- **Re-Titling of Assets.** It is extremely important that your assets be titled in a manner which is coordinated with your overall estate plan.

Be cautious when re-titling assets which you received

by way of gift or inheritance. Such re-titling may have the effect of allowing your spouse, in the event of a divorce, to make a claim on those assets (which claim would usually not otherwise be available).

- **Elder Law and Medicaid Planning.** It is possible that you or your spouse may enter a nursing home and, in such event, it is likely that you will incur costs in excess of \$10,000 per month. Medicare does not cover costs of a nursing home.

People who anticipate needing long-term care or who plan on using governmental benefits such as Medicaid should start planning at least five years in advance. To qualify for Medicaid, an individual in a skilled nursing facility may retain only \$2,000 of assets, while his or her spouse may retain a maximum of \$115,920.

Certain planning techniques are available whereby you can preserve assets for your heirs rather than seeing the assets consumed by the costs of a nursing home. It is important to consider these planning techniques well in advance of any potential move to a nursing home.

- **Changing Domicile to Another State.** Some states do not have any Estate Tax. Be aware, however, that simply purchasing a residence in another state is often not sufficient to be covered under that state's estate tax laws. You must establish "domicile" in the estate tax-free state. There is no precise method for determining someone's domicile, but the state where you are registered to vote, have your car registered, where you are a member of groups, and where you own real property are evidence of domicile.

- **Beneficiary Designations on Life Insurance and Retirement Plans** must be coordinated with the overall plan.

- **A Special Needs Trust** is a specialized legal document which is extremely beneficial to an individual with a disability. It enables a person with a physical or mental disability to have an unlimited amount of assets held in trust for his or her benefit while preventing these assets from being considered for the purpose of qualifying for certain governmental benefits like Medicaid. This is extremely important because these governmental benefits cover many services that medical insurance does not.

There are two basic types of special needs trusts: (a) a self-settled trust where the beneficiary's own assets are used to create the trust and (b) a third-party trust which is created with the assets of someone besides the beneficiary, like a family member or guardian.

Happy Holidays!