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ESTATE PLANNING NEWSLETTER

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The New Tax Law: How It Affects Your Income and Estate

The new Federal tax law and the elimination of the New Jersey Estate Tax are both effective as of January 1, 2018. First, there is no longer a New Jersey Estate Tax imposed on the estates of those whose deaths occur in 2018. Next, Congress and the President enacted The Tax Cuts and Jobs Act (“Tax Act”) which exempts estates with a value of less than \$11,210,000 for individuals from Federal Estate Tax. The Tax Act also changes a laundry list of income tax rules which will create a tax cut for most taxpayers. However, the Tax Act also creates winners and losers depending on a taxpayer’s situation. This newsletter will explain the New Jersey and Federal Estate Tax rule changes and present planning ideas to help reduce an individual’s overall tax liability. This newsletter will also explain some of the major income tax changes in the Tax Act and present ideas on how to arrange your financial affairs to minimize income tax liability.

Changes to Federal and New Jersey Estate Tax Laws

The **Federal Estate Tax** Exemption has been increasing over the past several years based on a federal inflation index. For 2018 the exemption was scheduled to be \$5,600,000, an increase of \$110,000 from last year. Along with the indexed increase, the new tax law doubles that amount resulting in an exemption of \$11,210,000 for each person. The exemption will continue to increase each year based on the inflation index. This essentially eliminates the Federal Estate Tax for all but the very wealthy. The number of taxable estates this year is estimated to be reduced from 5,000 to about 1,000 due to this change.

There are aspects of the Federal Estate Tax law that have not changed. First, “portability” remains. Portability allows the surviving spouse’s estate to apply the unused estate tax exemption from the previously deceased spouse’s estate against the assets of the second estate. Thus, a married couple together has a combined \$22,420,000 Federal Estate Tax Exemption.

Also, the step up in cost basis remains. The step up creates a new income tax cost for assets owned by a decedent equal to the date of death value of the assets. The potential income tax on assets that appreciate during lifetime is avoided. Therefore, most estates will not incur any Federal Estate Tax while the estate and beneficiaries will receive the benefit of the step up in tax cost basis.

While the increase in the exemption is significant, it is currently not permanent. Absent additional legislation, the new law will expire on December 31, 2025; on January 1, 2026 the exemption will be cut in half. Historically the Federal Estate Tax Exemption has not decreased once it has been raised but that trend may not continue.

The exemption also applies to lifetime gifts which provides an

alternative opportunity to take advantage of the increased exemption. The exemption can be used during lifetime and applied to avoid incurring a gift tax. Gifts can be made outright to descendants although an outright gift would cause the assets to eventually be included in the recipients’ estates. Alternatively, gifts can be made to trusts for the benefit of descendants or a spouse. In either case, the assets will not later be included in the taxable estates of the recipients, a significant estate planning benefit.

The **New Jersey Estate Tax** Exemption had remained constant at \$675,000 for over a decade. New Jersey enacted a law increasing the State Estate Tax Exemption to \$2,000,000 in 2017. By itself, this was a significant change. The law, however, went further and, effective January 1, 2018, the New Jersey Estate Tax has been repealed.

The **New Jersey Inheritance Tax** remains in effect. The Inheritance Tax is a tax based on the amount a beneficiary receives and the relationship of the beneficiary to the deceased. There is no Inheritance Tax on amounts passing to a spouse or descendants. Amounts passing to other beneficiaries may be taxed at 11% to 16%. If the Inheritance Tax will apply to your estate, it is possible to mitigate that tax by making gifts during lifetime. The use of trusts, rather than outright gifts and bequests, can avoid the imposition of the Inheritance Tax to the beneficiary’s estate.

The **Pennsylvania Inheritance Tax** remains in effect without change. In Pennsylvania, the Inheritance Tax does not apply to amounts passing to a spouse. There is, however, an Inheritance Tax on amounts passing to descendants with a tax rate of 4.5%. Again, gifts to trusts can mitigate this tax in your estate as well as the estates of your beneficiaries.

Income Tax Changes 2018

The Tax Act changed the tax rates for all taxpayers. The new tax rates are listed on page 4 of this newsletter. The good news is that the amount of tax due on the same “taxable income” is reduced in 2018. The following table illustrates the tax savings on identical taxable income at varying income levels.

<u>Filing Status</u>	<u>Taxable Income</u>	<u>2017 Tax</u>	<u>2018 Tax</u>	<u>Tax Savings</u>
Single	50,000	8,239	6,940	1,299
Married Joint	50,000	6,568	5,619	949
Single	100,000	20,982	18,290	2,692
Married Joint	100,000	16,478	13,879	2,599
Single	200,000	49,399	45,690	3,709
Married Joint	200,000	42,885	36,579	6,306
Single	300,000	82,399	80,690	1,709
Married Joint	300,000	74,217	60,579	13,638
Single	1,000,000	351,819	335,690	16,129
Married Joint	1,000,000	341,231	309,379	31,852

While the tax rate applied to taxable income creates winners for all taxpayers with a reduction in tax, additional changes in the Tax Act creates both winners and losers based upon the taxpayer's particular situation.

Standard Deduction and Personal Exemptions. For 2017 a taxpayer was allowed an exemption of \$4,050 for each taxpayer and dependent. For 2018, the exemptions are eliminated, and the standard deduction increased to \$24,000 for married filing jointly and \$12,000 for single taxpayers. The standard deduction is used for taxpayers who do not itemize their deductions. The following table illustrates that this change can create winners and losers.

					Married	
	Single		Married		2 Dependents	
	<u>2017</u>	<u>2018</u>	<u>2017</u>	<u>2018</u>	<u>2017</u>	<u>2018</u>
Stand. Ded.	6,350	12,000	12,700	24,000	12,700	24,000
Exemption	4,050	-	8,100	-	16,200	-
Total	10,400	12,000	20,800	24,000	28,900	24,000

Keep in mind that taxpayers whose itemized deductions exceed \$24,000 for married filing jointly and \$12,000 for single taxpayers would also lose under this provision of the Tax Act because of the elimination of exemptions.

Child Tax Credit. For 2017, the Child Tax Credit for children under the age of 17 was \$1,000 and was phased out for taxpayers whose income exceeded \$110,000 for married and \$55,000 for single. For 2018, the Child Tax Credit is increased to \$2,000 and the income phase out is \$400,000 for joint filers and \$200,000 for single. This provision of the Tax Act is a win for most families with minor children.

State and Local Tax. The deduction for state income tax and property tax, *combined*, is limited to \$10,000. For most taxpayers who itemize, this provision reduces itemized deductions and creates an increase in taxable income.

Qualified Business Income The biggest winners of the Tax Act are taxpayers with qualified business income. These taxpayers will obtain a 20% deduction on qualified business income, which results in that income being taxed at 80% of the normal rates. However, there are numerous restrictions which can be pitfalls for taxpayers or can result in planning opportunities for the well informed taxpayers.

The first step is to identify taxpayers who have qualified business income. These taxpayers receive their income from flow-through entities. Flow-through entities are S corporations, partnerships, business income reported on Schedule C, and rental income reported on Schedule E.

Certain business professionals in 11 categories face special rules which can reduce or eliminate a deduction for qualified business income. The 11 categories of business professionals with special rules are: (1) health, (2) law, (3) accounting, (4) actuarial science, (5) performing arts, (6) consulting, (7) athletics, (8) financial services, (9) brokerage services, (10) any trade or business where the principal asset is the reputation or skill of one or more employees, and (11) any trade or business which involves the performance of services that consist of investing and investment management, trading, or dealing in securities, partnership interests, or commodities.

However, this reduction or elimination only occurs (subject to a few other exceptions related to capital gains) if the taxable income exceeds \$315,000 for married taxpayer's filing jointly or \$157,500 for single taxpayers. For taxpayers with capital gains, the deduction is reduced by 20% of the capital gains.

A second reduction or elimination of the deduction for qualified business income occurs if taxable income is over \$315,000 for married taxpayers or \$157,500 for single filers. This limitation is a complex calculation (arguably not simplification); the deduction cannot exceed a specified percentage of the greater of (1) the salaries paid by the activity or (2) the sum of a portion of salaries paid plus a percentage of the value of “qualified property” used in the activity.

Continued on pg. 3

Celebrating 10 Years!

BHP is celebrating its 10th anniversary this year! On May 21, 2008, Jim Hatzell officially merged his practice with Jack Bernetich and Paul Pascu. Ten years later we are going strong with seven attorneys who collectively have 175 years of legal experience. We look forward to serving you and your family for many years to come.

BHP, in our continued commitment to be your full-service estate planning law firm, welcomes our newest associate, Elizabeth A. Patterson. Elizabeth, who has over twenty-five years of experience as a Social Security attorney, is focusing on Estate Planning, Guardianships, Trusts, Medicaid Planning, and Estate Administration.

Continued from pg. 2

It is beyond the scope of this newsletter to delve deeper into this formula, but a few rules of thumb can be gleaned. First, if taxable income is below \$315,000 for married filers or \$157,500 for single filers, you most likely will be eligible for the qualified business income deduction. This is true whether or not the income is earned in one of the 11 business professional categories. Second, if taxable income exceeds these limits, a comprehensive analysis of the underlying business activity specifically related to payroll and “qualified property” is needed. Third, if significant capital gains are recognized the deduction could be reduced or eliminated. Fourth, for income in excess of the limits, deductions will be phased-out proportionately over the next \$100,000 of income for married filers and \$50,000 for single filers.

The benefits of this deduction are significant. If a married taxpayer has \$350,000 of qualified business income and \$35,000 of adjustments and itemized deductions, taxable income is \$315,000. This would result in a deduction of \$70,000. The marginal tax rate is 24%. Tax savings from this provision alone would be \$16,800. From

a winner and loser perspective, if the same taxpayer earned \$350,000 of salary on a W-2, no deduction would be available.

The new qualified business income provisions present many planning opportunities. First, it may be possible to arrange a taxpayer's affairs to receive income as a flow-thru entity, rather than as salary. Second, a taxpayer may be able to contribute amounts to IRAs or 401(k)s to reduce taxable income below the \$315,000/\$157,500 limit. Third, taxpayers with qualified business income may be able to make key business purchases which can be deducted immediately in most cases under IRC section 179. Fourth, taxpayers may be able to offset capital gains with capital losses to prevent the potential reduction in the qualified business income deduction. Underlying all of these rules is that precise bookkeeping is essential. Near the end of each tax year, it is important to know the exact amount of taxable income to see if any of these planning techniques can be implemented.

Can a Nursing Home Hold Me Personally Responsible for My Loved One's Bill?

Deciding to admit a parent or loved one into a nursing home can be a very difficult decision. During the admissions process, the nursing home requires the signing of a seemingly endless stream of documents before your loved one is admitted. Although asking the nursing home to give you the opportunity to show all the documents to an attorney is prudent, practical considerations often result in simply signing all the documents so your loved one can be admitted right away.

The primary document you are asked to sign is an admissions agreement. You are frequently asked to sign on behalf of your loved one, and also as a “responsible party.” The responsible party often has control over their loved one's money and, for that reason, it is fair for the nursing home to ask you to personally sign the agreement. If you have control of your loved one's money, and fail to pay, it is likewise fair for the nursing home to file a lawsuit against you.

What happens when your loved one does not have enough money to pay for the nursing home? This is often the case when a nursing home accepts your loved one as a resident while an application for Medicaid benefits is pending. Between the day your loved one is admitted, and the day they are approved for Medicaid, a significant bill can accrue. There is a concerning trend where nursing homes are filing lawsuits directly against the responsible party, alleging that the responsible party can be held personally responsible for the bill. If you simply ignore the lawsuit filed against you, the court will give the nursing home a default judgment against you.

However, most people are unaware that this practice is illegal under

state and federal law. Federal law states, “[w]ith respect to admissions practices, a skilled nursing facility must not require a third party guarantee of payment to the facility as a condition of admission (or expedited admission) to, or continued stay in, the facility.” Likewise, New Jersey law states, “[a] nursing home shall not, with respect to an applicant for admission or a resident of the facility, require a third party guarantee of payment to the facility as a condition of admission or expedited admission to, or continued residence in, that facility; except that when an individual has legal access to a resident's income or resources available to pay for facility care pursuant to a durable power of attorney, order of guardianship or other valid document, the facility may require the individual to sign a contract to provide payment to the facility from the resident's income or resources without incurring personal financial liability.”

What should you do if you are sued by a nursing home under these circumstances? Most people are upset about having a lawsuit filed against them and are not aware that this practice is illegal. The thought of incurring legal fees as well as possibly being forced to pay the bill can make you feel helpless. This helpless feeling usually results in a hasty call to the nursing home to arrange some type of payment.

If suit is filed against you, immediately contact BHP. Although as a general premise, each party to litigation is responsible for their own attorney's fees under what is known as the American Rule, this may be one of the rare times where you could ask the court to force the nursing home to reimburse you for the attorney's fees you spent to defend the lawsuit.

Real Estate Tax Appeals

In New Jersey, real estate taxes are a substantial, if not the highest, single expense of home ownership. The tax you pay is based on the assessed value as determined by the municipality's tax assessor. Many properties, whether residential, commercial, or industrial, have current values that are below the assessed value. Our firm has experience working with real estate professionals and appraisers to evaluate the potential for an appeal of your property's assessment thereby reducing your tax burden. The annual deadline to file an appeal is April 1, but it is imperative to obtain information and evaluate the prospects for a successful appeal well in advance of the filing deadline.

New Jersey Inheritance Tax	
Class of Beneficiary	Tax Rate
Class "A": spouse, domestic partner, descendant, parent, step-child, mutually-acknowledged child	Fully exempt
Class "C": sibling, son/daughter-in-law	First \$25,000 - fully exempt Next \$1,075,000 - 11% Next \$300,000 - 13% Next \$300,000 - 14% Over \$1,700,000 - 16%
Class "D": any beneficiary who does not qualify as Class "A", "C", or "E"	If under \$500 - fully exempt If over \$500, first \$700,000 - 15% Over \$700,000 - 16%
Class "E": Charities and other exempt entities.	Fully exempt

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%

Federal Estate Tax Exemption		
Year	Exemption	Tax Rate
2016	\$5,450,000	40%
2017	\$5,490,000	40%
2018	\$11,210,000	40%

Single Life Table Excerpt (for RMD for Inherited IRA)					
Age	Dist. %	Age	Dist. %	Age	Dist. %
37	2.15%	55	3.38%	73	6.76%
38	2.19%	56	3.48%	74	7.09%
39	2.24%	57	3.58%	75	7.46%
40	2.29%	58	3.70%	76	7.87%
41	2.34%	59	3.83%	77	8.26%
42	2.40%	60	3.97%	78	8.77%
43	2.46%	61	4.10%	79	9.26%
44	2.51%	62	4.26%	80	9.80%
45	2.58%	63	4.41%	81	10.31%
46	2.64%	64	4.59%	82	10.99%
47	2.70%	65	4.76%	83	11.63%
48	2.78%	66	4.95%	84	12.35%
49	2.85%	67	5.15%	85	13.16%
50	2.92%	68	5.38%	86	14.08%
51	3.00%	69	5.62%	87	14.93%
52	3.10%	70	5.88%	88	15.87%
53	3.18%	71	6.13%	89	16.95%
54	3.28%	72	6.45%	90	18.18%

New Jersey Estate Tax		
Year	Exemption	Tax Rate
2016	\$675,000	Up to 16%
2017	\$2,000,000	Up to 16%
2018	None	None

Uniform Lifetime Table (for RMD for IRA Owners)					
Age	Dist. %	Age	Dist. %	Age	Dist. %
70	3.65%	80	5.35%	90	8.77%
71	3.77%	81	5.59%	91	9.26%
72	3.91%	82	5.85%	92	9.80%
73	4.05%	83	6.13%	93	10.42%
74	4.20%	84	6.45%	94	10.99%
75	4.37%	85	6.76%	95	11.63%
76	4.55%	86	7.09%	96	12.35%
77	4.72%	87	7.46%	97	13.16%
78	4.93%	88	7.87%	98	14.08%
79	5.13%	89	8.33%	99	14.93%

Federal Income Tax Rates							
2017 Taxable Income - Tax Rates				2018 Taxable Income - Tax Rates			
Tax Rate	Single	Married, Filing Jointly	Estates and Trusts	Tax Rate	Single	Married, Filing Jointly	Estates and Trusts
10%	\$0-9,325	\$0-18,650	---	10%	\$0-9,525	\$0-19,050	\$0-2,550
15%	\$9,326-37,950	\$18,651-75,900	\$0-2,550	12%	\$9,526-38,700	\$19,051-77,400	---
25%	\$37,951-91,900	\$75,901-153,100	\$2,551-6,000	22%	\$38,701-82,500	\$77,401-165,000	---
28%	\$91,901-191,650	\$153,101-233,350	\$6,001-9,150	24%	\$82,501-157,500	\$165,001-315,000	\$2,550-9,150
33%	\$191,651-416,700	\$233,351-416,700	\$9,151-12,500	32%	\$157,501-200,000	\$315,001-400,000	---
35%	\$416,701-418,400	\$416,701-470,700	---	35%	\$200,001-500,000	\$400,001-600,000	\$9,150-12,500
39.6%	Above \$418,400	Above \$470,700	Above \$12,500	37%	Over \$500,000	Over \$600,000	Above \$12,500

New Jersey Ret. Income Exclusion			
Year	Single	Married, Jointly	Married, Separately
2017	30,000	40,000	20,000
2018	45,000	60,000	30,000
2019	60,000	80,000	40,000
2020+	75,000	100,000	50,000

Long-Term Capital Gains Rates		
Tax Rate	Single Income	Married, Filing Jointly Income
0%	Up to \$38,600	Up to \$77,200
15%	\$38,601-425,800	\$77,201 to 479,000
20%	Over \$425,800	Over \$479,001

Federal Gift Tax Annual Exclusion	
Year	Exemption Amount
2017	\$14,000
2018	\$15,000

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