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McNEES INSIGHTS

Asset Planning and Federal Taxation

2011 TAX LAW CHANGES

By David M. Watts

The 2010 Tax Relief Act brought not only federal estate and gift tax changes, but also other changes that affect individual taxpayers. These changes can be summarized briefly as follows:

- Employees will pay only 4.2%, instead of the usual 6.2%, Social Security tax on compensation received during 2011, and self-employed persons will pay only 10.4% Social Security self-employment taxes, down from 12.4% in 2010, for earned income of up to $106,800, which results in a maximum savings per taxpayer of $2,136, and for a husband and wife of $4,272.

- The reduced individual income tax rates in effect during 2010 are continued for another two years, which means that the highest individual tax rate is 35% through 2012, and with capital gains and qualified dividends taxed at a maximum 15% rate.

- The repeal of the limitation on itemized deductions and the personal exemption phase out is continued through 2012, so higher income taxpayers will not have to be concerned about having their itemized deductions and personal exemptions reduced for another two years.

- The marriage penalty relief and enhancement to the child tax credit in effect through 2010 is extended through 2012.

- The 2010 Tax Relief Act retroactively "patched" the alternative minimum tax so as to increase the exemption amount for 2010 to $47,450 for single individuals, $72,450 for married couples and surviving spouses, and $36,225 for married individuals filing a separate return. The exemption amount is increased for 2011 to $48,450 for single individuals, $74,450 for married couples and surviving spouses, and $37,225 for married individuals filing a separate return. Without the retroactive "patch," the exemption amounts would have been $33,750 for single individuals, $45,000 for married couples and surviving spouses and $22,500 for married individuals filing a separate return, and absent legislative action, these will be the exemption amounts for 2013.

- Most over-the-counter medicines can no longer be reimbursed from the various types of health savings accounts (which has caused doctors to be inundated with requests for prescriptions for items such as contact lens solution and aspirin).

- Among other temporary tax incentives extended by the 2010 Tax Relief Act are:

    - o State and local sales tax deduction
    - o Teachers' classroom expense deduction
    - o Tax rate distributions from IRAs to charitable organizations
    - o Higher education, IRAs, tuition deduction
    - o Modified energy tax credit ■

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IN THIS ISSUE

ESTATE PLANNING AND THE 2010 TAX ACT

By David M. Watts, Jr.

On December 17, 2010, President Obama signed into law the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (the "Act"). The enactment of this legislation resulted in several important changes for federal estate and gift tax law. While there was no federal estate tax for 2010, in 2011 the federal estate tax was scheduled to return with a $1 million exemption and a maximum marginal rate of 55%. The Act reduces the 2011 and 2012 maximum federal estate tax rate to 35%, and increases the exemption to $5 million per person. In addition, the pre-2010 rules concerning the step up in basis for assets at death are reinstated, and the Act provides for estate tax exemption "portability", which means that a deceased spouse's unused estate tax exemption can be utilized at the death of the surviving spouse.

Notwithstanding the favorable estate tax rates and estate tax exemption in 2011 and 2012, after 2012 the federal estate tax increases to a maximum marginal rate of 55% and the unified credit reduces to $1 million per person, with no portability.

The Act provides significant planning opportunities during the next two years because the $5 million exemption applies on a unified basis to both the gift and estate taxes, with gifts made during lifetime exceeding the annual exclusion amount reducing the amount of the $5 million exemption available at death. This means that individuals can make gifts to the next generations of up to $5 million per person over the next two years, and avoid the consequences of a possible return to the $1 million exemption and 55% maximum federal estate tax rate. While we do not advise that clients immediately start gifting assets to the next generations, as 2013 approaches, we will need to keep a careful watch on what direction Congress appears to be heading with respect to 2013 estate and gift tax legislation.

The $5 million exemption does raise some possible issues for those with older estate plans that use a formula for determining the amount that funds what is usually called the unified credit or credit shelter trust. These formulas were designed under the assumption that the federal estate tax exemption would remain in the range of $1-$2 million. Therefore, if your estate plan has not been updated during the past ten years, or if it contains a formula funding a unified credit or credit shelter trust, you should be talking with your estate planning advisor for the purpose of updating your documents. In addition, if your powers of attorney were done prior to the year 2000, those too should be updated, because changes in state law concerning powers of attorney has resulted in changes to the form documents used for those purposes. ■

PLANNING AND PAYING FOR LONG-TERM CARE (PART 1 IN A SERIES)

By Scott Alan Mitchell

The U.S. Department of Health and Human Services (HHS) estimates that at least 70% of people over age 65 will need long-term care services at some point in their lives – and over 40% will need care in a nursing home for some period of time. Although "long-term care" is defined to include various levels or types of care, such as in-home care, adult day care, personal care, assisted living, and skilled nursing care, the bulk of long-term care planning involves skilled nursing care, and so the focus of this series will be on skilled nursing care.

IN PENNSYLVANIA, THE CURRENT AVERAGE COST OF NURSING CARE IS OVER $7500 PER MONTH.

In Pennsylvania, the current average cost of nursing care is over $7,500 per month. However, in central and eastern Pennsylvania, it is common to see costs ranging from $8,000 to as high as $11,000 (or more) per month. For most families and/or spouses, paying upwards of $100,000 per year for care creates a significant (perhaps impossible) financial hardship.

Unfortunately, many individuals operate under the assumption that they will never go into a nursing home -- or they incorrectly believe that Medicare or their secondary health insurance policy will pay for skilled nursing care -- and so they often fail to pre-plan financially for this astronomical expense that HHS estimates will impact 12 million individuals by the year 2020. Also, many individuals delay any planning under the belief that they do not have to worry about the possibility of nursing care for years to come. However, current surveys show that one out of seven individuals (just over 14%) in skilled nursing care is under the age of 65.

According to national statistics, skilled nursing care currently is paid from the following sources:

1. 5.3% - "Other public/private" (such as perhaps a nursing home's benevolence fund)
2. 7.2% - Private insurance
3. 18.1% - Out of pocket
4. 20.4% - Medicare
5. 49% - Medicaid (known as "Medical Assistance" in Pennsylvania)

As this series of articles continues, I will take a closer look at Medicare and private health insurance, long-term care insurance, and Medicaid/Medical Assistance. As reflected in the above statistics, Medical Assistance is by far the largest source of payment for nursing care. For those who have not pre-planned for nursing care or have insufficient assets to pay privately for care, Medical Assistance certainly provides a valuable safety net for families to preserve assets.

However, as will become clear later in this series, Medical Assistance also involves a complex web of state and federal statutes, regulations, and internal governmental policies that must be navigated. The process of becoming eligible for Medical Assistance often can be quite cumbersome and intimidating for clients as significant assets often need to be spent or "re-arranged" to become eligible for assistance. Also, with ongoing news of deficits and budget cuts, it is unclear what Medical Assistance might look like in the future. Thus, for families who either cannot or do not want to risk depleting their assets by $100,000 per year for skilled nursing care, pre-planning options such as long-term care insurance provide a good alternative to consider. ■

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McNEES WELCOMES SCOTT ALAN MITCHELL

The Asset Planning and Federal Taxation group welcomes Scott Alan Mitchell. Scott concentrates primarily in the areas of estate and trust planning and administration, with a particular emphasis on elder law, long-term care planning, and special needs planning and administration for children, adults, and trustees, and related areas of guardianships and Orphans' Court practice. He is a frequent speaker on these issues to professional, civic, and church groups.

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