

**FEDERAL AND NEW JERSEY  
ESTATE TAX UPDATE**

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Presented by:

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## ESSENTIAL ESTATE PLANNING DOCUMENTS

- I. **Last Will and Testament:** Disposition instrument that instructs the executor of your estate to dispose of your probate estate in a particular fashion. If no valid Will, the Laws of Intestacy apply
  - A. Probate versus Non-Probate Property
    1. **Probate Property** - passes under will (investment or bank account owned individually, real estate owned individually or as Tenant-in-Common, tangible personal property)
    2. **Non-Probate Property** - passes pursuant to Beneficiary Designation Form or to Joint Owner. Examples include retirement plans, IRAs, life insurance and jointly held property.
  - B. New Jersey Intestacy Statute
  - C. Reasons to Avoid Intestacy
    1. State of New Jersey (not you) determines who gets your assets
    2. Who will be Executor/Administrator, Trustee, Guardian
    3. Young beneficiaries receive outright bequests
- II. **Beneficiary Designation Forms:** Documents that control the disposition of some of your non-probate assets including life insurance, 401(k) plans, IRAs etc.
- III. **Power of Attorney:** Names an agent to manage your financial affairs
- IV. **Living Will:** Appoints a Health Care Representative to make medical decisions on your behalf and provides guidance to the Health Care Representative (i.e. your wishes)
- V. **Revocable Trust:** A documents that serves as a Will substitute. While it provides no estate tax advantages, it can help avoid probate which is particularly beneficial in some states (ex. Florida). It is common for individuals who have real estate in multiple states to transfer their "out-of-state" real estate to a Revocable Trust to avoid an ancillary administration. Revocable Trusts are often combined with so-called pour-over wills.

# FEDERAL TRANSFER TAXES

## I. Federal Gift and Estate Tax

### A. The New (Albeit Temporary) Law

1. On December 17, 2010, President Obama signed The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010. In addition to extending President Bush's income tax cuts, the Act addresses the Estate, Gift and Generation Skipping Transfer ("GST") tax laws for 2010, 2011 and 2012.
2. The Act does not cover the year 2013 or beyond. Absent further legislation, in 2013, the laws as they existed in the year 2002 will apply (\$1,000,000 estate and gift tax exemption and 55% rate).

### B. Federal Gift Tax

1. Application: "The gift tax applies to a transfer by way of gift whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible."
2. Marital Deduction: Unlimited gifts to United States citizen spouses allowed
3. Annual exclusion of \$13,000 per beneficiary - \$26,000 if married couple agrees to split gifts
4. Charitable Deduction
5. Payment of Education or Medical Expenses
6. Lifetime gift tax exemption is now \$5,000,000
7. Gift Tax
  - a. Rate – 35%
  - b. Paid by Donor
  - c. Carryover Basis
8. PLANNING POINT: There is no guarantee that the \$5,000,000 lifetime exemption will continue past 2012. Accordingly, many individuals will benefit from making significant gifts to their children and grandchildren (or to trusts for their benefit) during 2011 and 2012.

### C. Federal Estate Tax

1. Beginning on January 1, 2010, the federal estate tax was repealed. Prior to repeal, there was a federal estate tax on estates that exceeded \$3.5 million. Starting in 2011, the federal estate tax exemption is \$5,000,000 and the top rate is 35%.
2. The following chart illustrates the federal gift, estate and generation-skipping transfer tax changes over the past few years:

	<u>2009</u>	<u>2010</u>	<u>2011 &amp; 2012</u>	<u>2013</u> <sup>1</sup>
Estate Tax Exemption	\$3,500,000	All Exempt	\$5,000,000 <sup>2</sup>	\$1,000,000
Estate Tax Rate	45%	0%	35%	55%
Gift Tax Exemption	\$1,000,000	\$1,000,000	\$5,000,000 <sup>3</sup>	1,000,000
Gift Tax Rate	45%	35%	35%	55%
GST Exemption	\$3,500,000	\$3,500,000	\$5,000,000	\$1,030,000
GST Rate	45%	0%	55%	55%

### D. Portability

1. The Act also introduces, for the first time, the concept of "portability". By way of background, under prior law, if an individual died and failed to utilize all of his/her gift and estate tax exemption, this exemption was forever lost. Under the Act, a surviving spouse would be able to utilize the unused exemption of his/her "deceased spouse" if the deceased spouse died after 2010. This means that, with respect to a typical husband and wife, if, in 2011, the husband dies and does not fully use his estate tax exemption, the unused exemption is then attributed to the wife, so that when she dies, her estate plan can use both her estate tax exemption and her late husband's unused exemption.

**EXAMPLE:** If, in 2011, the first spouse to die has a \$5,000,000 estate and utilizes only \$1,500,000 of exemption at death, the estate of the surviving spouse will have an \$8,500,000 (\$5,000,000 + \$3,500,000) exemption available at his or her subsequent death.

<sup>1</sup> Subject to future legislation.

<sup>2</sup> \$5120,000 in 2012

<sup>3</sup> \$5,120,000 in 2012

2. Portability does not apply to New Jersey Estate Tax.

**E. Carryover Basis Rules – Optional for 2010 Estates**

1. For Decedent's dying in 2010, the Act provides a "choice" for the Executor. They may choose NOT to have the federal estate tax apply and receive a modified carryover basis or they can choose to have the federal estate apply and receive a step-up in basis to the date of death value.
2. An executor may allocate \$1,300,000 of increased basis among the estate assets (plus an additional \$3,000,000 increased basis to any property passing to the surviving spouse or marital trust).

**F. What Does the Future Hold?**

1. Exemption Levels
2. Tax Rates
3. Portability Between Spouses
4. Step-Up vs. Carry-Over Basis
5. **FLEXIBILITY** is the key to future estate planning

## **NEW JERSEY INHERITANCE AND ESTATE TAX**

**I. New Jersey Inheritance and Estate Tax**

**A. New Jersey Inheritance Tax**

1. In calculating the amount of transfer inheritance tax due, the key factor is the nature of the relationship between the decedent-transferor and the beneficiary (rate of tax varies based on the classification of the beneficiary)
2. For New Jersey resident decedents, the inheritance tax is imposed on the transfer of intangible property wherever situated and personal and real property located in New Jersey
3. Deductions: Reasonable and ordinary expenses of estate administration

4. New Jersey Inheritance Tax Rates:

<u>Beneficiary</u>	<u>Exemption</u>	<u>Tax Rate</u>
Spouse, parents, children, stepchildren, domestic partner, civil union partner	None	None
Siblings, children-in-law	\$25,000	11%-16%
Others	\$500	15%-16%
Charities	None	None

**B. New Jersey Estate Tax**

1. An estate tax is imposed on the estates of New Jersey resident decedents when the inheritance and death taxes paid to New Jersey and other states is less than the maximum credit allowed to the estate under the Internal Revenue Code as it existed on December 31, 2001
2. Imposed on estates **greater than \$675,000** with a maximum rate of 16%
  - a. December 31, 2001 law applies
  - b. In light of the new federal estate tax laws, a Credit Shelter Trust may receive all assets passing under a will resulting in unnecessary New Jersey Estate Tax being due.
3. **EXAMPLE:** Husband dies with assets valued at \$5,000,000. His will, which was drafted in 1999 (when the federal estate tax exemption was \$650,000), provides that the maximum amount possible without creating a federal estate tax should pass to a credit shelter trust for the benefit of his spouse. Accordingly the trust is funded with \$5,000,000 million and approximately \$400,000 in New Jersey Estate Tax is due. If Husband's Will had instead provided that only the maximum amount possible that could pass free of *New Jersey Estate Tax* should fund the credit shelter trust and that the balance of his estate should pass outright to his spouse, no tax would be due.
4. **PLANNING POINT:** In planning for New Jersey residents, the key is to strike a balance between taking full advantage of the federal estate tax exemption and the payment of New Jersey Estate Tax

## THE "PROPERLY" PLANNED ESTATE

### I. Marital Deduction

- A. All amounts bequeathed to surviving United States citizen spouse pass tax-free
- B. Interest must be non-terminable, i.e., cannot lapse after a term of years

### II. Use of Applicable Exemption Amount

- A. Shelter amount equal to decedent's available exemption amount
  - 1. Federal (\$5,120,000) in 2012
  - 2. New Jersey (\$675,000)
- B. Can pass outright to or in trust for benefit of spouse or non-spouse beneficiary
- C. Trust can allow beneficiary certain rights
  - 1. Right to income
  - 2. Limited right to corpus of trust according to ascertainable standard or discretion of trustees other than surviving spouse

### III. Examples:

- A. The "Sweetheart" Will – Husband dies in 2011 with assets valued at \$10,000,000. His will provides that his entire estate is to pass to his Wife. No federal or New Jersey estate tax will be due because of the unlimited marital deduction. However, if the \$10,000,000 grows in value and is worth \$15,000,000 at the time of Wife's death, approximately \$1,750,000 ( $\$5,000,000 \times 35\%$ ) of federal estate tax will be due and approximately \$1,900,000 ( $\$15,000,000 \times 16\%$ ) of New Jersey Estate Tax will be due.
- B. The Planned Estate – The facts are the same as in the above example except this time, Husband's Will provides that the maximum amount possible for federal estate tax purposes passes to a credit shelter trust for the benefit of his Wife. This amount (\$5,000,000), and all future appreciation on it, will be exempt from federal and New Jersey estate tax upon Wife's death. Accordingly, if the \$5,000,000 originally placed in the trust is worth \$7,500,000 at Wife's death, the family will realize a federal estate tax savings of \$875,000. However, approximately \$400,000 of New Jersey Estate Tax will now be due upon Husband's death.

- C. Again, in planning for New Jersey residents, the key is to strike a balance between taking full advantage of the federal estate tax exemption and the payment of New Jersey Estate Tax.
- D. The use of a trust(s) for the benefit of the surviving spouse also offers other, non-tax advantages such as:
  - 1. Protection from creditors
  - 2. Protection from subsequent marriages
  - 3. The appreciation in value of the assets in the trust also escapes taxation

**IV. Potential DISASTERS caused by the increase in the Federal Estate Tax Exemption**

- A. Reliance on a formula to allocate your estate between children and spouse

**EXAMPLE:** Husband dies with assets valued at \$5 million. His will, which was drafted in 2006 when the federal estate tax exemption was only \$1.5 million, provides (via formula) that the maximum amount possible without creating a federal estate tax should pass to his children from a prior marriage and the balance of his estate should pass to his spouse. In light of the increased federal estate tax exemption, Husband's children will receive his entire estate and nothing will pass to his spouse.

- B. Reliance on a formula to allocate amount a spouse or other beneficiary receives outright versus in a trust

**EXAMPLE:** Husband dies with assets valued at \$5 million. His will, which was drafted in 2008, provides that the maximum amount possible without creating a federal estate tax should pass to a trust for the benefit of his spouse and the balance of his estate should pass outright to his spouse. In light of the significant increase in the federal estate tax exemption, the Wife will receive her entire inheritance in trust and approximately \$400,000 of New Jersey Estate Tax will be due.

## EXAMPLES

- I. Married Couple with \$2 million and 2 children
  - a. Sweetheart Will
  - b. Mandatory Credit Shelter Trust – federal exemption formula
  - c. Disclaimer Will
  - d. NJ-Only Credit Shelter Trust
  - e. All assets are jointly owned
  - f. Spouse with no assets dies first
- II. Married Couple with children from a prior relationship
  - a. Sweetheart Will
  - b. Q-tip Trust
- III. Married Couple with \$10 million and 2 children
  - a. Portability – no growth
  - b. Portability – with growth

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**Brian D. Reynolds, Esq.** is a shareholder with Mantell, Prince & Reynolds, P.C. and focuses his practice on matters relating to tax and estate planning, business and succession planning for entrepreneurs, professionals and closely-held businesses, the administration of estates and trusts, estate and trust litigation, taxpayer representation in connection with federal and state tax controversies, charitable planning, and a broad range of personal legal matters.

Mr. Reynolds is a member of the Union County Bar Association and a frequent lecturer for several organizations including the New Jersey Society of Certified Public Accountants, the New Jersey State Bar Association and the New Jersey State Bar Foundation. Mr. Reynolds received his B.S. from York College of Pennsylvania (cum laude), his J.D. from New York University School of Law (cum laude) and his Masters of Laws in Taxation from New York University School of Law. Mr. Reynolds is admitted to practice law in both New Jersey and New York. In 2011, Mr. Reynolds was chosen for the New Jersey Law Journal's *40 Under 40* which recognizes the top 40 attorneys in the State of New Jersey who are under the age of 40. Mr. Reynolds was also designated a *Rising Star* by New Jersey Super Lawyers.

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The Firm's practice extends to major areas of law relating to the representation of corporations, business enterprises, family enterprises, and individual entrepreneurs and professionals. Due to the nature of our practice, we routinely serve as general counsel to individuals, families and businesses working hand-in-hand with a team of advisors to provide the highest level of legal advice.

Estate Planning. The Firm's estate and trust practice includes counseling families, businesses, executives and fiduciaries in conserving, transferring and managing substantial assets. We provide a full range of estate planning services, including preparation of sophisticated wills and trusts, business succession planning, generation-skipping transfer tax planning, and the implementation of lifetime gifting programs. The Firm also advises fiduciaries in connection with the administration of estates and trusts.

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Not-for-Profit Practice. Arising in part from its representation of wealthy individuals and families, the Firm advises many private foundations.

Trust and Estate Litigation and Dispute Resolution. The Firm is regularly involved in cases pertaining to disputes within families regarding contested wills, trust administration, challenged gifts and forced inheritance laws. In addition to litigating these cases, we have successfully negotiated resolutions of such disputes in creative, tax-efficient ways that minimize family strife, expense and publicity.

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