

**UNION COUNTY BAR ASSOCIATION**  
**ELDER LAW COMMITTEE**  
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**USING TRUSTS TO MINIMIZE THE NEW JERSEY ESTATE TAX**

**IMPACT OF NEW JERSEY ESTATE TAX UPON CLIENTS**

The New Jersey Estate Tax is based on the Federal Estate Tax law as it existed in 2001. There is an unlimited deduction for dispositions to spouses or charities. Any other transfers in excess of \$675,000.00 are subject to the tax. Before 2002, the New Jersey Estate Tax was simply a component of the Federal Estate Tax. This means that a credit was allowed against the Federal Estate Tax due for the estate taxes paid to New Jersey. The Federal Economic Growth and Tax Reconciliation Act of 2001 (EGTRA) increased the Federal exemption causing a loss of revenue to the State. Moreover, the elimination of the credit created a second reason for the State's loss of funds. As a result of this loss of revenue, New Jersey decided to decouple its estate tax from the Federal Estate Tax.

This Estate Tax will have a continued impact upon many New Jersey middle class taxpayers. The New Jersey Estate Tax includes all real and personal property owned by decedent including life insurance and retirement accounts. Many older married couples have homes and other assets that exceed \$1,350,000.00.

**HOW TO EFFECTIVELY USE TRUSTS TO PLAN**  
**FOR IMPACT OF NEW JERSEY ESTATE TAX**

**Credit Shelter Trust Limited to New Jersey Exemption Amount**

The estate plan can provide that the amount passing to the New Jersey credit shelter trust for the benefit of the spouse be fully funded with the decedent's assets at the first death in the New Jersey exemption amount (\$675,000.00). These trusts are commonly referred to as credit shelter, bypass or family trusts. They are drafted so that the assets will not be added to the estate of the survivor.

**Surviving Spouse Rights Over Credit Shelter Trust**

1. The right to serve as trustee or sole trustee (be careful about sole trustee);
2. The right to receive all income from the trust;
3. The right to receive trust corpus (under an ascertainable standard) such as for the health, education, maintenance and support of the surviving spouse;
4. A "5 by 5" power which gives the spouse the right to withdraw the greater of five percent (5%) of the trust principal at the beginning of the year or \$5,000.00 (whichever is greater); and
5. The right to distribute monies among a limited or defined class of individuals (children usually) so that the trust is not included in the estate by virtue of the surviving spouse's right being deemed equivalent to that of a general power of appointment under I.R.C. §2041.

**ENSURE TRUST CAN BE FUNDED AT DEATH OF FIRST SPOUSE**

- ◆ To the extent possible, divide assets between spouses. Non-income producing real estate can be prime asset to re-title since eliminates liquidity concerns of surviving spouse.
- ◆ If all or most assets are held jointly at death of first spouse, credit shelter trust is useless unless surviving spouse takes affirmative steps to disclaim jointly owned assets within nine (9) months from decedent's death under I.R.C. §2518.

**WHAT CAN HAPPEN TO REMAINDER OF ESTATE  
OF FIRST SPOUSE TO DIE?**

- ◆ Distribution outright to surviving spouse qualifies for marital deduction.
- ◆ Remainder of estate can be devised to a Q-TIP (Qualified Terminal Interest Property) Trust which qualifies for marital deduction by way of executor election. I.R.C. §2056(7).

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- ◆ Surviving spouse has right to income for life. Testator can then control distribution of trust assets at the subsequent death of surviving spouse. Proper tool in second marriages where decedent wants to provide for spouse but distribute corpus to his heirs at death of his spouse.
- ◆ All assets in Q-TIP Trust and growth of same between death of first spouse and second spouse will be subject to New Jersey Estate Tax (and Federal, if applicable) at death of second spouse.
- ◆ This plan ensures there will be no payment of New Jersey Estate Tax at death of first spouse which can be an important goal for estates between \$1.4 and \$2.0 million.

**USE OF DISCLAIMER TRUST**

- ◆ Another option to plan for New Jersey Estate Tax is use of disclaimer trust. It works best when both spouses have common heirs. Flexible alternative.
- ◆ A disclaimer trust in a Will devises the entire estate to the surviving spouse. If the surviving spouse disclaims the inheritance, the Will can direct the inheritance to a trust for the spouse as allowed by I.R.C. §2518.
  1. Spouse can fund trust with \$675,000.00 (or more) based on a variety of circumstances that actually exist at the time of the death of the first spouse. These factors include:
    - (a) Size of combined estates at first death;
    - (b) Applicable Federal Estate Tax exemption;
    - (c) The likelihood the surviving spouse will remain a New Jersey resident; and
    - (d) The likelihood that New Jersey will continue to impose a State tax.
- ◆ This flexible plan is based on the assumption that more will be known at the time of death of first spouse than when the Wills and estate plan were prepared.

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- ◆ It may be that paying a New Jersey Estate Tax at death of first spouse is more desirable than paying a Federal Estate Tax at the possible rate of fifty-five percent (55%) in 2011.
- ◆ Example: If \$2,000,000.00 passes to a credit shelter trust, the amount in excess of \$675,000.00 (\$1,325,000.00) is subject to the New Jersey Estate Tax in the amount of \$99,600.00.
- ◆ Depending on circumstances at death of first spouse, that might be more desirable than allowing the \$1,325,000.00 to appreciate between deaths of spouses and be subject to a much higher Federal tax rate at death of second spouse.

**Requirements of Disclaimer**

1. Disclaimer must be completed and filed in the County Surrogate's Office within nine (9) months of the date of death. I.R.C. §2518.
2. For real estate, the disclaimer must also be filed with recorder of Deeds.
3. While New Jersey Disclaimer Statute does not require that the disclaimer be filed within nine (9) months, the only limitation imposed is that the disclaimant cannot actually accept property. N.J.S.A. 3B:9-9.
4. The transfer to the disclaimer trust is not considered a gift by the disclaimant for gift tax purposes and it is treated as a gift directly by the decedent as if the disclaimant had predeceased.

**ADVANTAGES OF DISCLAIMER TRUST**

- ◆ Flexibility provided to surviving spouse in determining when to pay New Jersey and Federal estate taxes.
- ◆ Surviving spouse has substantial powers over the trust and yet trust is not included in the estate of the surviving spouse. In this way the trust operates in manner similar to a credit shelter trust. I.R.C. §2518(b)(4) and Treas. Reg. 20.2518-2(e)5 Ex. 5.

### **DISADVANTAGES OF DISCLAIMER TRUSTS**

- ◆ Surviving spouse is in an emotional state and may be unwilling to perform the analysis in a relatively short period of time required to decide whether to disclaim some or all of estate.
- ◆ Many times surviving spouse, at the direction of life insurance agents, brokers or bankers, has already transferred joint accounts into her name and, therefore, accepted the property thereby making a disclaimer unavailable.

### **Rights of Surviving Spouse as to Disclaimer Trust**

1. Surviving spouse can serve as sole trustee.
2. Surviving spouse can receive all income from the trust.
3. Surviving spouse can receive principal for health, education, maintenance and support (HEMS).
4. Surviving spouse cannot hold a lifetime or testamentary power of appointment.
5. Code and regulation are not entirely clear as to whether surviving spouse can exercise a 5 by 5 power. It might be considered a general or special power of appointment which a spouse cannot have as to a disclaimer trust. Treas. Reg. 25.2518-2(e)(2).

### **FACTORS TO CONSIDER AS TO USE OF DISCLAIMER TRUST**

- ◆ Client must be comfortable that the surviving spouse will adhere to the desires of the deceasing spouse. Example: Tom and Mary are married. Tom dies and Mary accepts the entirety of the property, remarries and leaves the corpus to a new husband or alternate heirs.
- ◆ Disclaimer trust may not be appropriate in second marriage situation where there are children from a prior marriage.

**UNINTENDED CONSEQUENCES OF ESTATE PLANS**  
**DRAFTED BEFORE CONSIDERATION OF NEW**  
**JERSEY ESTATE TAX**

- ◆ Many estate plans had Wills with mandatory Federal exemption credit shelter trusts and no Q-TIP trusts.
  
- ◆ Examples: Husband and wife have a total estate of \$1,900,000.00. Husband predeceases owning \$1,000,000.00 of the total \$1,900,000.00 of estate assets. Credit shelter trust is funded with \$1,000,000.00 (2002-2003 Federal exemption amount). If surviving spouse cannot take a partial Q-TIP election on \$325,000.00 of the \$1,000,000.00 passing to the bypass trust, then \$33,200.00 of New Jersey Estate Tax is due at the first death.
  
- ◆ Alternatively if goal in above example is not to pay New Jersey Estate Tax upon death of first spouse, then the wife, as surviving spouse, should consider a partial Q-TIP election on \$325,000.00 (assuming a Q-TIP trust was established in first spouse's Will). This would mean that \$675,000.00 would fund the bypass trust thereby eliminating the \$33,200.00 in New Jersey Estate Tax that would otherwise be payable at the first death. The additional \$325,000.00 would be taxable upon the death of the wife together with the wife's own \$900,000.00.