

MEMORANDUM

EARP COHN P.C.

TO: Our Clients and Friends

FROM: Irving Koffler, Earp Cohn P.C.

DATE: August 2009

RE: **ESTATE PLANNING CONSIDERATIONS FOR 2009 AND BEYOND**

Federal Estate and Gift Tax Provisions.

Current provisions of the Internal Revenue Code impose an estate tax on transfers at death. In general, the federal estate tax is imposed on estates that exceed specific applicable exemption amounts. These exemptions were significantly modified by legislation in 2001, including a sunset provision in 2010 which eliminated the estate tax, only to have such tax re-established with a low base exemption in 2011. The exemptions per individual for last year and years 2009 - 2011 are as follows:

2008	\$2,000,000
2009	\$3,500,000
2010	Estate tax eliminated
2011	\$1,000,000

Because of budgetary constraints existing in 2001, Congress set the repeal and re-institution of the federal estate tax, anticipating that the exemptions and status of federal estate tax would be addressed by future Congressional action. Current budgetary and other political and economic issues will certainly have an impact on the legislation that will be considered. Many commentators do not expect the federal estate tax to go away in 2010. We share that view. We also do not expect the relatively low \$1,000,000 exemption scheduled for 2011 to come back into existence. During the election campaign, President Obama's position was to maintain the \$3,500,000 exemption after 2009. Consistent with such objectives, the House and Senate in the Budget Conference Agreement approved on April 29, 2009, included a provision that would permanently extend the \$3,500,000 exemption for individuals and \$7,000,000 for couples. The specifics of this proposal, if enacted, will be incorporated into the final legislation to be approved this year.

Notwithstanding the increase in the applicable federal estate tax exemption, the gift tax exemption remains at \$1,000,000. The estate and gift tax provisions are based on a unified system and because the 2011 floor is still operative, it would be an inconsistent position to increase the gift tax exemption above the potential estate tax level that could come into effect in 2011. The annual exclusion of qualifying gifts per individual, \$13,000 in 2009 (increased from \$12,000 in 2008), is still in effect over and above the lifetime exemption.

Example: In 2007, Alice, a single individual, made a gift of \$100,000 to her daughter. Alice died in 2008 with an estate of \$2,500,000. For 2007, there was a taxable gift of \$88,000 (\$100,000 - \$12,000). However, Alice did not have to pay a gift tax, but merely had her \$1,000,000 lifetime exemption reduced to \$912,000 (\$1,000,000 - \$88,000). Upon Alice's death in 2008, her applicable estate tax exemption of \$2,000,000 was reduced by the prior taxable gift. Therefore, her remaining exemption would be \$1,912,000 (\$2,000,000 - \$88,000) and her taxable estate would be \$588,000 (\$2,500,000 - \$1,912,000).

Had Alice's death occurred in 2009, there would be no federal estate tax, because Alice's exemption would have increased to \$3,500,000, and her remaining applicable exemption amount would have been \$3,412,000, (\$3,500,000 - \$88,000) which would be in excess of her remaining assets.

New Jersey Inheritance and Estate Tax Provisions.

New Jersey does not impose an "inheritance" tax on property passing to a spouse, children (or grandchildren), or to parents and grandparents. Property passing to others, including siblings or friends, is subject to inheritance tax at rates varying from 11% to 15%.

Separate and distinct from the "inheritance" tax is the New Jersey "estate" tax. Prior federal law allowed a dollar for dollar credit for state death taxes (subject to a limit). Accordingly, even if no inheritance tax were imposed on an estate, New Jersey and most other jurisdictions imposed an "estate" tax to capture the credit without adversely impacting on a resident individual's estate. This tax is frequently referred to as the "sponge" or "pick-up" tax because the total tax was the same, but was merely shifted from the IRS to the State. To prevent a significant revenue loss when the federal tax laws changed, New Jersey along with several other states including New York, enacted legislation to "decouple" their State estate taxes from federal law. The New Jersey decoupling legislation had the effect of freezing the exemption for the New Jersey estate tax at \$675,000 (i.e. the amount applicable before the federal law changed in 2001).

Accordingly, many estates that are not subject to federal estate tax will incur a New Jersey estate tax liability. If the individual's estate is subject to the federal estate tax, the amount of estate tax paid to New Jersey is deductible in arriving at the taxable estate. Generally, the

taxable amount for New Jersey estate tax purposes includes all assets passing to a person other than a spouse. Accordingly, for a single individual it will be the entire estate.

Examples: Joe, a single individual, dies in 2009 and leaves his entire estate of \$1,000,000 to his children. Under the Internal Revenue Code there would be no federal estate tax due. Also, there is no New Jersey inheritance tax because all of the beneficiaries are children. However, because of the decoupling legislation, the New Jersey estate tax would be \$33,200.

Incidentally, if Joe were a Pennsylvania resident and died leaving his entire estate to his children, the Pennsylvania inheritance tax would be \$45,000, since Pennsylvania imposes an inheritance tax of 4.5% on property passing to children.

If Joe's taxable estate were \$2,000,000, the New Jersey estate tax would be \$99,600. If the taxable estate were \$3,500,000, the New Jersey estate tax would be \$229,200.

Planning Opportunities.

The recent decline in real estate values and the securities market, coupled with the significant increase in the federal estate tax applicable exemption to \$3,500,000, now changes the fundamental analysis for many estates. Estates that previously might have been subject to the federal estate tax are now non-taxable. This is particularly true for married couples where, with proper planning, up to \$7,000,000 can be exempted from the federal estate tax. Of course, all of this is based on future legislation. The President's budget proposal, along with the Congressional Budget Agreement, lead us to believe that the \$3,500,000 exemption will continue in 2010 and thereafter.

Items for consideration include the following:

1. REVIEW EXISTING DOCUMENTS. Clients may want to change the marital/residuary formula in existing documents so that allocations will be based upon the state death tax exemption rather than the federal exemption. While it is possible for married couples to avoid the New Jersey estate tax by using a device called a "QTIP election," individuals may wish to set up disclaimer trusts, which give additional flexibility to surviving spouses.

Example: Assume a married couple with total assets of \$1,000,000. Since there would be no federal estate tax, their estate plan may provide that the entire estate passes to the survivor. If the value of assets remains constant, there would be no federal estate tax on the death of the surviving spouse. If this scenario were utilized, then on the death of the surviving spouse, the

survivor's estate in excess of \$675,000 (the New Jersey exemption) would be subject to a New Jersey estate tax of \$33,200. If the parties had included a disclaimer trust in their documents, they could avoid the New Jersey estate tax on the second estate. This favorable result could be accomplished while allowing the surviving spouse all of the economic benefit and control of assets in the disclaimer trust.

2. **RETITLING ASSETS AND BENEFICIARY DESIGNATIONS.** Assets can be retitled between spouses so that the available exemptions for both federal and state purposes may be fully utilized. If assets are properly retitled, then \$1,350,000 ($\$675,000 \times 2$) can be exempt for New Jersey estate tax purposes, and \$7,000,000 ($\$3,500,000 \times 2$) can be exempt for federal estate tax purposes. Beneficiary forms should be reviewed. Insurance policies, IRA's, retirement plans, and similar assets pass pursuant to the terms of the beneficiary designation, rather than your Will or Trust. Since these assets frequently are a large portion of an individual's estate, a regular review of these beneficiary designations is important. In certain cases making benefits payable to a trust for your beneficiaries may be advantageous. Jointly-owned property passes to the surviving joint owner, rather than pursuant to the terms of a Will or Trust. As such, placing assets in joint names may defeat planning opportunities.

3. **LIFETIME GIFTS.** Using the annual exclusion (\$13,000 per individual) or lifetime exclusion (\$1,000,000) may be advantageous for both federal and New Jersey purposes. Depending on your estate and your marital situation, you may wish to make *inter vivos* gifts to reduce your estate below the exemption amounts and reduce or eliminate the exposure to either the federal estate tax or the New Jersey estate tax, or both.

4. **BUSINESS PLANNING.** Take this opportunity to review your business situation. Review the buy-sell agreement and, if the business does not have one, consider putting an agreement in place. Also, consider transferring interests to family members. Because of the economic turndown, you may be able to obtain a low valuation for some of these assets, and under current law minority interests in a business may be transferred at discounted values.

5. **REVIEW OF IRREVOCABLE LIFE INSURANCE TRUSTS ("ILITs").** To fund the payment of federal estate taxes and other planning objectives, many individuals established ILITs funded with life insurance. Since estates may no longer be subject to federal estate taxation, the need for an ILIT should be re-evaluated.

6. **INTER VIVOS OR TESTAMENTARY CHARITABLE GIFTS.** The current economic climate has made the needs of charities even more urgent. Individuals may wish to make lifetime gifts that are currently deductible for income tax purposes. Alternatively, individuals may want to include gifts for charities in their Wills or Trusts. In addition to direct gifts to charities, some families wish to create charitable trusts or foundations which can be currently funded and provide a vehicle for family members to make future charitable gifts from the fund. Individuals frequently use charitable remainder trusts, or charitable lead trusts, to implement these programs.

7. PLANNING TO TAKE ADVANTAGE OF LOW INTEREST RATES. Many tax and estate planning strategies are based on IRS valuation tables which are used to determine the value of gifts to individuals and charities. In a low-interest environment, the IRS tables present an enhanced opportunity to implement gifts via private annuities, grantor retained annuity trusts, and charitable lead trusts. Alternatively, low interest rates make other strategies (such as a charitable remainder trust) more costly from a tax standpoint.

8. POSTPONING RETIREMENT PLAN AND IRA DISTRIBUTIONS. While this memo is intended to focus on estate planning, recent legislation involving required minimum distributions allows such distributions to be postponed during 2009 (without having to be distributed at a later date). Postponing the distribution will create an income tax saving, and will allow the amount not distributed to accumulate tax-free.

Non-Tax Considerations.

Surveys show that more than 50% of adults do not have a Will. In addition, many who do have Wills and other estate planning documents have not reviewed or revised them to take into account changed circumstances. Non-tax considerations should always be the primary objective in estate planning. Changes in family situations that may impact on the need to re-evaluate your planning include:

- Birth of a child or grandchild
- Death or divorce of a spouse
- Marriage or divorce of a child
- Ability of persons named to serve as executor or trustee
- Need for a guardian
- Second marriage
- Desire to implement charitable giving
- Special needs trust for relatives with disabilities
- Medicaid planning
- Need for a Living Will and/or Power of Attorney
- Civil union legislation

Summary.

While the changes in the federal estate tax and anticipated future legislation will benefit you and your heirs, the interplay between the federal and New Jersey estate taxes adds a level of complexity. We invite you to contact our office to schedule an appointment so that we can re-examine your estate plan with you to help minimize estate taxes and establish an appropriate program to meet your current objectives.