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## **Does the New Jersey Estate Tax Affect You And If So What to Do About It By Thomas D. Begley, Jr.**

### **I. THE TAX**

On July 1, 2002, New Jersey enacted a New Jersey estate tax. Historically, there has been a New Jersey estate tax, but for all practical purposes New Jersey simply received a portion of the money that would have been paid to the federal government under the federal estate tax. Under the Bush-sponsored Economic Growth and Tax Relief Reconciliation Act of 2001 the credit to the states was reduced and was scheduled to be eliminated in 2005. To make up for this lost revenue stream New Jersey, as well as a number of other states, have decoupled their estate tax from the federal estate tax and enacted their own new laws.

Under the newly-enacted New Jersey estate tax law the tax begins at \$675,000. Since the federal estate tax exemption is \$1,000,000 for 2002, there would be New Jersey estate tax but not federal estate tax on the \$325,000 difference. The tax would be \$33,200. As the federal exemption increases, the New Jersey tax also increases. Most estate plans provide that a by-pass trust be established in an amount equal to the federal estate tax exemption. Using this formula will create a liability for New Jersey estate tax as follows:

<b>Year of Death</b>	<b>Federal Exemption</b>	<b>New Jersey Estate Tax if Full Exemption Used</b>
2002-03	\$1,000,000	\$33,200
2004-05	\$1,500,000	\$64,400
2006-08	\$2,000,000	\$99,600
2009	\$3,500,000	\$229,200

While the law is unclear, it would appear that any amounts left to a surviving spouse would not be subject to the New Jersey estate tax. However, amounts left in a Q-TIP trust for the benefit of a surviving spouse likely would be subject to New Jersey estate tax. Typical estate plans created prior to 2002 established a credit shelter trust or by-pass trust in an amount equal

to the federal estate tax exemption with the remainder either being passed outright to the surviving spouse or in a Q-TIP trust for the benefit of the surviving spouse. These estate plans will result in liability for New Jersey estate tax.

Example: A husband and wife each have \$1,000,000. They designed an estate plan whereby the \$1,000,000 is placed in a credit shelter trust upon death. The husband dies first. There is no federal estate tax due, because the \$1,000,000 is within his \$1,000,000 federal estate tax exemption. On the wife's subsequent death, there is no tax, because her \$1,000,000 estate is also subject to the \$1,000,000 exemption. Prior to July 1, 2002, there would have been no New Jersey estate tax due on either death. After July 1, 2002, there would be a tax due in the amount of \$33,200 on each estate, or a total of \$66,400.

## II. POSSIBLE SOLUTIONS

- *Disclaimer Trust*

One possible solution for a married couple would be the utilization of a disclaimer trust. Under this scenario the husband, who is the first to die in the above example, would leave his entire estate to his wife. Upon the husband's death the wife would have the opportunity to either accept the entire \$1,000,000 or disclaim \$675,000 to the credit shelter trust if the wife wanted to avoid the New Jersey estate tax, or she could elect to disclaim the entire \$1,000,000 into the credit shelter trust, and pay the New Jersey estate tax if this was advantageous. The New Jersey estate tax is less than 10 percent and it may be more economical to pay this tax on the first death than to pay a larger federal estate tax on the death of the surviving spouse, since that tax in 2002 begins at 41 percent.

- *Q-TIP Trust*

The law does not indicate whether a Q-TIP trust is the equivalent of a gift to the spouse, which would succeed in deferring the New Jersey estate tax until the death of the spouse. If the law is clarified to permit such an arrangement, a Q-TIP trust would be a means of avoiding the tax on the death of the first spouse. In the example above, the husband would redraft his documents to leave \$675,000 in the credit shelter trust and the balance to a Q-TIP for the benefit of his wife. Upon the husband's death there would be no federal or New Jersey estate tax due.

- *Annual Exclusion Gifting*

A person exceeding the \$675,000 New Jersey estate tax threshold may consider making annual exclusion gifts limited to \$11,000 per donee.

- *Irrevocable Life Insurance Trusts*

The proceeds of irrevocable life insurance trusts would not be subject to the New Jersey estate tax.

- *Changing Domicile*

One way to avoid the New Jersey estate tax would be to move to another state that does not have an estate tax. The problem is that because the economy is weak nationally and all state revenues are shrinking, it is likely that most, if not all, states will adopt legislation similar to New Jersey's in the near future.

- *Gifts in Excess of \$11,000*

Each person has a \$1,000,000 exemption from federal gift tax. Gifts in excess of \$11,000 would count against this \$1,000,000 federal gift tax exemption, but would avoid the New Jersey estate tax. Before making large gifts taxpayers should consider the impact of carry over basis and should strongly consider whether they will ever need the money themselves in the future.

### **III. LIENS**

New Jersey state taxes a lien against all assets in the estates of New Jersey residents provided the assets are located in the state. This means that 50 percent of all assets will be frozen upon death. While the law is unclear, the state has indicated that assets in a revocable living trust will not be frozen. Because of the simplicity of probate in New Jersey living trusts have not been popular. There is now a reason for living trusts in New Jersey.

### **IV. CONCLUSION**

Due to the changes in the federal estate tax law enacted in calendar year 2001 effective in 2002 and the enactment of the New Jersey estate tax effective on July 1, 2002, every estate plan for families having assets in excess of \$675,000 must be examined. In most instances wills and trusts may need to be redrafted. Failure to do so may result in the payment of significant unnecessary taxes and living with the burden of unnecessary trusts.



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