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ESTATE PLANNING IN THE NEW 2013 TAX WORLD

I. LIFETIME GIFTS

A. Federal Gift Tax

1. Each individual may give up to $14,000 to any person and as many people as desired each year (annual exclusion) without any gift tax consequences. This amount is indexed for inflation and will be going up but not again for a couple of years, probably.
2. The payment of certain medical and educational expenses directly to the service provider or institution is not considered a gift under §2503(e) of the Internal Revenue Code (IRC)
   a. Any medical expense that would be deductible, such as doctor, hospital, pharmacy, therapist, dentist, orthodontist, premiums for health care insurance, medical equipment
   b. For education, only tuition to a qualified educational institution is exempt
   c. The exception to the gift tax can be very helpful when we want to assist elderly parents and adult children who may have no or inadequate medical coverage on the medical side and can help our children educate our grandchildren from nursery school through grad school
3. There is an applicable exclusion amount against gifts in excess of the annual exclusion currently allowing for $5,250,000 of taxable gifts during the lifetime without paying gift tax, for gifts made in 2012, which exemption (indexed for inflation from the $5,000,000 of 2011) is made permanent by the American Taxpayer Relief Act of 2012, signed into law on January 2, 2013 (the “2013 Tax Act”).
   a. The rate structure for gifts in excess of $5,250,000 is 40%.
   b. Any applicable exclusion amount used during lifetime is not available at death as a charge against the exemption at that time
   c. Many people are making large gifts now to use some or all of the $5,250,000 gift tax exemption to deflect income and growth to their beneficiaries.
4. Certain gifts in trust can qualify for the annual gift tax exclusion. See C. below

B. Federal Generation Skipping Transfer Tax

1. In addition to the regular gift tax, we also have a Federal Generation Skipping Transfer Tax (“GST”) on gifts to or for someone at least 2 generations younger than the donor (“skip persons”)
2. Skip person: grandchildren and below, grandnieces and grandnephews, any unrelated person at least 37.5 years younger than the donor
3. If the child of the donor who is the parent of the grandchild is deceased, then the grandchild moves up a generation and is not considered a skip person for the gift and there is no GST
4. Rate of tax: the highest gift tax rate in effect at the time of the gift, which is 40%
5. Exemption from the GST: it is the same as the exemption from the regular Federal Estate Tax, which is $5,250,000, pursuant to the 2013 Tax Act.
6. Use of the exemption from the GST is made by an election on a gift tax return to allocate exemption
7. Certain gifts that qualify for the regular gift tax annual exclusion also qualify for the GST annual exclusion, such as

a. outright to the skip person
b. UTMA gifts
c. Gifts to an IRC §2503(c) trust for minors
d. IRC §2503(e) payments of tuition and medical expenses

But not gifts to irrevocable life insurance trusts or other trusts with more than one beneficiary

8. You could use some regular gift tax exemption and not use GST exemption, and vice versa on certain lifetime gifts, so the exemptions remaining at date of death of the donor could end up very different – lifetime gifts must be closely monitored and accounted for so that the donor is aware of the amount of each of the exemptions that is used during life and then available at death

C. Saving for children and grandchildren

1. Custodial accounts (UTMA accounts)
   a. Irrevocable gift to the minor (individual under age 21)
   b. An adult is designated as the custodian and the custodian cannot be the donor
   c. The funds can only be used for the minor.
   d. All income is taxable to the child whether it is distributed to or for the child or not.
   e. At 21, the child can withdraw the funds.
   f. Qualifies for both regular gift tax and GST annual exclusions
2. Trust for minors (IRC §2503(c) trusts)
   a. Irrevocable gift in trust
   b. For the benefit of one individual who is under age 21
   c. Must not be limited to specific purpose, but must be broadly for the beneficiary
   d. Income can be accumulated until 21;
   e. Actual trust is established with a trustee other than the donor
   f. Only income that is distributed to or for the beneficiary is taxable to the beneficiary and the balance of the income is taxable to the trust
   g. Child must have at least a 30-day period at age 21 to withdraw the funds, but if the child does not, the funds can remain in the trust until a later age or ages specified in the trust;
   h. Without the above terms, transfers to the trust will not qualify for the annual gift tax exclusion and will be adjusted taxable gifts using lifetime exemption from gift tax
   i. The trust for minors qualifies for both regular gift tax and GST annual exclusions
3. HEET trust (Health and Education Exclusion Trust)
   a. Any trust from which payments are made directly to an educational institution for tuition only or directly to a medical service or medical product provider for the benefit of an individual so that the payments are not considered gifts under IRC §2503(e)
   b. This trust may provide for other distributions to or for the beneficiaries, but other distributions to or for skip persons will result in GST tax unless GST exemption is allocated to the trust in a year when the GST is applicable
   c. This can be a trust for multiple beneficiaries and multiple generations, and should include at least one non-skip person to avoid imposition of GST immediately upon creation
   d. To use the annual gift tax exclusion for additions to this trust, the beneficiaries must have a certain power, called a Crummey withdrawal power, which requires written notice to the beneficiaries of their right of withdrawal
   e. This trust requires allocation of GST exemption to be free of GST upon distributions to or for grandchildren, other than the above IRC §2503(e) payments
4. IRC §529 Qualified State Tuition Program (QSTP)
   a. New Jersey, and many states, have established QSTPs under §529 of the Code.
   b. Under a QSTP, a person may establish an account for the purpose of meeting qualified higher education expenses of a designated beneficiary
   c. Post-secondary schools only
   d. Benefits include:
      i. Contributions into the account qualify for annual gift tax exclusion

ii. Tax-free growth while in the account
iii. Tax-free use of funds for qualified education expenses
iv. Ability to accelerate annual exclusion gifts, as much as five in one year (i.e. pre-funding the account and start it growing sooner) – may use 5 years of annual exclusions to front-load the account
v. Includes tuition, fees, books, equipment, room and board, not just tuition as with the IRC §2503(e) exclusion from the gift tax
vi. Donor has power to change the beneficiary to another beneficiary of the same generation, especially if the first beneficiary does not need or use the entire account
vii. Payment does not have to be made directly to the institution, and can reimburse the beneficiary
viii. Qualifies for the GST annual exclusion

e. Drawbacks include:
   i. A penalty is assessed if the funds are used for anything other than educational expenses
   ii. Must be careful not to over-fund the account
   iii. Contributions must be in cash
   iv. Possible gift tax consequences to a beneficiary if there is a change in beneficiary
   v. Precludes use of annual exclusion for other gifts for that year or the 5 year period if use the front-loading exception so must keep careful track of annual exclusions used each year
   vi. If donor front-loaded and then dies during the 5 year period, the annual exclusions for the years after death are recaptured in the estate administration

5. Kiddie tax for children under age 19, (or 24 in the case of a student) generally, if the earned income does not exceed half of the child’s support
   a. The first approximately $1,000 ($950 for 2012) currently of unearned income is free of federal income tax;
   b. The next approximately $1,000 currently of unearned income is taxed at the child's rate; and
   c. The income in excess of approximately $2,000 currently is taxed at the parents' rate.
6. Caveat: use of custodial or trust funds for a child's education or general support may result in the income from that fund being taxed to the parents

D. Helping elderly parents
   1. IRC §2503(e) payments of medical expenses
   2. supervising caregivers directly or through the use of a geriatric care manager
   3. participating in health care decisions and treatment and proper administration of medications
   4. the need for health care directives, HIPAA statements and powers of attorney

II. PLANNING FOR AGING – OUR OWN AND OUR PARENTS

A. Guardianship
   1. The formal proceeding
   2. Continual court monitoring
   3. Expensive, time consuming and traumatic to patient
   4. Who should be appointed

B. Documents to avoid the problems of guardianship
   1. Property
      a. Power of Attorney
      b. Living Trust

2. Medical care
    a. Health care proxy
    b. Living Will
    c. HIPAA statement

C. Property
  1. Power of Attorney
    a. Individual designated to handle assets and financial affairs for the principal
    b. Must be durable to be useful (survives the incapacity of the principal)
    c. Extinguished on death
    d. Who should be appointed
    e. General vs. limited
    f. Presently exercisable vs. springing upon a certain event or incapacity
    g. One or more agents, jointly, alternatively or sequentially
    h. Special powers to include: ability to make gifts, ability to handle tax matters
  2. Living Trust
    a. Governs the use and management of assets and income during the individual's lifetime and distribution on death
    b. Irrevocable or revocable
    c. Standby or funded, initially, fully or partially
    d. Difference between living trust and trust established under a will - See V. below
    e. Becoming more popular in NJ for variety of reasons including avoidance of estate tax lien, ease of administration on death of grantor, ease of change of trustee in future, privacy, etc.
  3. Need both documents
    a. Power of attorney can become "stale", even though the new statute says no, making it more difficult to use and manage assets in the event of a long term illness
    b. Trustee has broader powers
    c. Living trust is the most flexible devise to manage investment assets but may have assets outside of trust that need management or disposition
    d. Person holding power of attorney can exercise the power to fund the trust, moving the assets from the individual's name to the living trust

D. The high cost of growing old
  1. Planning for medical care
    a. Health care insurance
    b. Medicare
    c. Medi-gap policy
  2. Planning for the high cost of home or custodial care
    a. Long term care insurance
    b. Medicaid qualification and assistance

  3. Factors to consider in long term care insurance
    a. Starting date, i.e. waiting period or disqualification period
    b. Payment amount
      i. Fixed amount
      ii. Inflation rider
    c. Term, i.e. how long it pays (3 years, 5 years, life)
    d. Institutional care and/or home care
    e. Conditions covered, i.e. Alzheimer's, brain disorders, cognitive impairment, activities of daily living
    f. Limitations re pre-existing conditions
    g. Quality of insurance company
    h. Automatically renewable

i. Who should be insured – husband, wife, joint policy
j. Discount for person in more than 3 year committed relationship

4. Transfers of assets to qualify for Medicaid – watch out for Medicaid disqualification period

E. Medical care

1. Health care proxy or designation of health care representative
   a. Gives individual the opportunity to designate the person wanted to make medical decisions if the individual cannot make those decisions for self
   b. Helps the doctor or other health care provider know who has the authority to speak for the patient
   c. Any competent adult may be designated a health care representative – family member, friend, companion, but not an employee, officer or director of the health care facility unless that individual is a family member
   d. One or more alternative health care representatives, in order of priority
   e. Can direct the health care representative consult with a specified individual, such as children or others
   f. Operative only if the individual is incapable of making own decisions
2. Living will directive
   a. A statement of desires with respect to health care and life sustaining treatments
   b. General treatment philosophy and objectives or specific instructions
   c. With or without the designation of a health care representative
   d. Assures that the individual's wishes regarding health care and treatment in the final stages of a terminal illness will be respected by family and health care providers
   e. Removes burden from family and others regarding life and death decisions
   f. Clear and convincing evidence and statement of desires and subjective intent
3. HIPAA statement
   a. When the principal is not incapacitated but wants someone to be able to assist with health care issues, obtain medical information and records and speak with medical care providers
   b. who: all health care representatives named in the health care directive, plus any others such as additional children, parents, siblings, etc. who principal wants involved with care
   c. Someone to go to doctor appointments with an older or less informed or capable principal for that 2nd set of ears to hear what the medical professional is telling the patient
   d. Someone who can speak with the medical professionals in the presence of or outside the presence of the patient
4. Separate documents or all in one
5. All are revocable – even if incompetent
6. Include specific instructions in the event of pregnancy, organ donation, willingness to have nutrition and hydration withheld or not

III. ESTATE PLANNING - WHY DO YOU NEED A WILL?

A. Passage of property

1. With a will, you can specify where your property passes and in what manner, i.e. trust for minor children to provide management by manager selected by decedent and defer time of distribution later than age 18.
2. Without a will, the NJ laws of intestacy provide:
   a. If there is a spouse and no descendant or parent of decedent, or if all of the decedent's descendants are also descendants of the spouse and spouse has no other descendants, then the entire estate passes to spouse
   b. If there is a spouse, no descendants survive but parent(s) survives, spouse receives the first 25% of the interest estate, but not less than $50,000 nor more than $200,000, plus 75% of the balance, and parents receive the balance, equally if more than one
   c. If there is a spouse and separate descendant(s) of decedent or spouse, the spouse receives the first 25% but not less than $50,000 nor more than $200,000, plus 1/2 balance

of intestate estate

d. Anything not passing to the spouse, as provided above, passes to the following in the listed order:
   i. decedent’s descendants, by representation, or if none,
   ii. decedent’s parents equally, or all to the survivor, or if none
   iii. descendants of decedent’s parents, by representation (ie siblings, nieces, nephews), or if none,
   iv. ½ to paternal grandparents if surviving, or their descendants, per stirpes, and ½ to maternal grandparents if surviving, or their descendants by representation, or all to one side if there is no one on the other side (i.e. cousins), or if none,
   v. decedent’s step-children, including former step-children or descendants by representation

e. By representation vs. per stirpes
   i. per stirpes: by the branches of the family tree
   ii. by representation: start the branches at the first generation below the decedent that has any members, ie if none of the children are surviving, then equal at the grandchildren generation

B. Appointment of Executor
1. You can specify who will administer your estate in your will. You will want to make sure the executor has adequate knowledge, expertise and time to do the job properly.
2. The law provides the following priority of individuals eligible to serve as executor.
   a. Surviving spouse
   b. Next of kin, who is a distributee of the intestate estate, with those of equal degree of relationship generally having an equal right to serve (i.e. all 5 children)
   c. If there are no heirs who can or do qualify within 40 days, then any fit person can serve.
3. You can eliminate the need for a bond (type of insurance) by will and eliminate dispute among potential administrators and the need for a renunciation.

C. Appointment of a guardian for minor children (probably hardest decision) and a trustee for their property.

D. For a will to be effective, you must make sure your assets are owned properly and all beneficiary designations are correct and consistent with the intended estate plan.

IV. PROBATE ESTATE V. TAXABLE ESTATE

A. Probate Estate
1. All assets in the name of the decedent alone and without a named beneficiary; and
2. All assets in the name of the decedent with another without right of survivorship; and
3. All assets made payable to the estate by beneficiary designation (i.e. life insurance, IRAs, IRC §401(k) plan benefits, etc.); and
4. Decedent’s interest in property owned with another person as tenants in common
5. These assets pass under the terms of decedent's will.

B. Taxable Estate
1. All probate assets plus
2. Assets not included in probate estate, but in the taxable estate for federal and New Jersey estate tax purposes
   a. Life insurance and other benefits (i.e. IRA, pension, IRC §401(k) plan) payable to anyone other than the estate as the result of a beneficiary designation, including a trust (other than a properly established and administered ILIT, see XIV below); and
   b. All or a portion of assets owned jointly with right of survivorship with someone other than a

spouse based on proportion of contribution, and one-half of property owned as tenants by entirety or jointly with a spouse.

c. These assets pass to the designated beneficiary or joint owner, respectively, regardless of the provisions of the will and even though they are taxable to the estate (but see special rules for the New Jersey Inheritance Tax below with respect to real estate owned jointly by spouses, qualified plan benefits payable to a spouse and life insurance payable to anyone other than the estate).

C. Shift of assets

1. How property is owned must be known prior to doing any estate planning
2. There may need to be a change in the form of ownership of assets or beneficiary designation to be certain the assets pass as desired and to maximize the tax benefits to a plan
3. Determine if there are any co-ownership, partnership, premarital or other agreements controlling the ability to transfer by will or trust

V. COMPARISON OF POUR-OVER WILL WITH LIVING TRUST AND WILL WITH TESTAMENTARY TRUST

A. Definitions

1. A pour-over will is a short will that states that all assets, after debts, taxes, expenses and specific bequests, are to be paid over to the living trust. The trust describes the administration of the assets both during the individual's lifetime and after death, including all dispositive provisions.
2. A will with a testamentary trust includes all dispositive provisions in the one document, and is not effective until after death.

B. Comparison: between the Pour-over Will & Revocable Living Trust Will with the Will with a Testamentary Trust as a part of the Will

1. There are essentially no income, gift or estate tax differences. During life, the revocable trust is a grantor trust and all income, ordinary and capital gain, is taxed to the grantor as if there were no trust. The gift tax on transfers from the trust or the individual are essentially the same. On death, there is no difference for NJ inheritance or estate tax, federal estate tax, or generation skipping transfer tax. Hence, the living trust, in and of itself, is not a tax saving device. It is the substance of the documents that creates the tax benefit not the form of documents.

Pour-over Will & Revocable Living Trust	Will with Testamentary Trust
2. The grantor may fund the trust during life to obtain: a. Professional management or merely management of assets by another; b. Ability to have someone else pay debts and expenses for the grantor; c. Important in the event of incapacity	The trust cannot exist until death a. left with use of general durable power of attorney to have someone else manage and handle assets
3. Privacy a. during lifetime, the assets are in the name of the trust, not the grantor b. the trust agreement need not become a public document during life or after death and at the probate of the will	a. cannot be used during lifetime b. the will becomes a public document on probate

<u>Pour-over Will & Revocable Living Trust</u>	<u>Will with Testamentary Trust</u>
4. Probate a. still need a will to dispose of anything remaining in decedent's name, i.e. tangibles, checking account outside trust b. minimal cost to the Surrogate c. 10 day wait to probate will but that has no Impact on assets in the trust already	a. disposes of all assets in decedent's name for which there is no beneficiary b. minimal cost to the Surrogate c. 10 day wait
5. Smooth and quick transition to beneficiaries on death to the extent the trust is funded during life. If the trust is not funded or not fully funded during life, there is no difference. The NJ estate tax lien does not apply to assets held in trust.	The NJ estate tax lien on all assets causes delay and difficulty in management and distribution of assets. Only ½ of assets of the estate are immediately available for management and distribution upon admission of the will to probate, and the balance after the filing and approval of the NJ estate and inheritance tax returns, which could be year and a half or more.
6. Costs of probate: a. executor's commission only on probate assets, not assets already in the trust b. maybe reduced counsel fees	a. executor's commission on all probate assets (with limitations), even though the assets pass to the trust u/w, plus trustees commissions on the trust once funded.
7. Costs during life: start paying trustee commissions upon funding during life.	No trustee commissions until the trust is funded after death. NOTE: the use of the funded living trust may just trade an executor commission for a trustee commission so that there is little if any difference in the total commissions paid to fiduciaries over the course of administration of the estate and initial stages of the trust
8. Grantor needs the agreement of the trustee to amend, unless grantor is his or her own trustee.	Testator may make unilateral changes to the will.
9. Ability to withstand challenge to will or trust or elective share claim: no real difference	same
10. Claims of creditors: Qualified plan or insurance proceeds payable directly to the trust may not be subject to claims of decedent's Creditors. Decedent's assets transferred to the revocable trust during life and not protected from creditors.	All probate assets are subject to the claims of creditors, so if benefits are payable to the estate, they may be subject to claims, but if paid directly to a testamenta trust, may be protected.

11. S corporation stock Living trust can hold stock during the life of the grantor And up to 2 years after the death of the grantor. The trust may hold the S corp. stock thereafter if it is a QSST or ESBT.	Estate can hold stock during entire administration of the estate.

VI. NJ TRANSFER INHERITANCE TAX

A. There is currently no inheritance tax on assets passing to spouses, parents, grandparents, lineal descendants, and step-children of the decedent.

B. For siblings and spouses of children of the decedent, there is a $25,000 exemption and then tax rates of 11% to 16%.

C. For all others there are tax rates of 15% to 16%, with no exemption, unless the total bequest is under $500 – this includes descendants of a step-child.

D. Real estate held by spouses as tenants by the entireties, qualified plan benefits payable to the spouse and life insurance payable to anyone or any trust but not the estate are exempt from the New Jersey Inheritance Tax.

VII. FEDERAL ESTATE TAX

A. In 2013, each individual has an applicable exclusion amount for property left to anyone in the amount of $5,250,000, pursuant to the 2013 Tax Act. The exclusion amount increased from 2001 until it reached $3,500,000 in 2009 and then $5,000,000 in 2010 and 2011 and $5,120,000 for 2012 as a result of the Tax Act signed on December 17, 2010. The 2013 Tax Act signed on January 2, 2013, extends the $5,000,000, indexed for inflation from 2011, permanently (or until Congress changes it again), resulting in an applicable exclusion amount for 2013 of $5,250,000.

B. The following chart shows the phase-in of the applicable exclusion amount and tax rates, historically, currently and as presently stated in the law for the next few years, unless they are further tinkered with by Congress:

Year	Minimum tax rate	Top Federal Estate Tax, GST Tax and Gift Tax Rate	FET Exemption Amount	GST Exemption	Gift Tax Exemption
2001	37%	55% + 5% on large estates	$ 675,000	$1,060,000	$ 675,000
2002	41%	50%	$1,000,000	$1,100,000	$1,000,000
2003	41%	49%	$1,000,000	$1,120,000	$1,000,000
2004	45%	48%	$1,500,000	$1,500,000	$1,000,000
2005	45%	47%	$1,500,000	$1,500,000	$1,000,000
2006	45%	46%	$2,000,000	$2,000,000	$1,000,000
2007	45%	45%	$2,000,000	$2,000,000	$1,000,000
2008	45%	45%	$2,000,000	$2,000,000	$1,000,000
2009	45%	45%	$3,500,000	$3,500,000	$1,000,000
2010	35%	35%	$5,000,000	$5,000,000	$1,000,000
2011	35%	35%	$5,000,000	$5,000,000	$5,000,000
2012	35%	35%	$5,120,000	$5,120,000	$5,120,000
2013	40%	40%	$5,250,000	$5,250,000	$5,250,000
After 2013	40%	40%	Indexed for inflation from the $5m of 2011	Indexed for inflation from the $5m of 2011	Indexed for inflation from the $5m of 2011

In addition, for decedents dying in 2011 and 2012, the gift and estate tax applicable exclusion became "portable" as between spouses so that it is a $10,000,000/$10,240,000 per couple exclusion, not just $5,000,000/$5,120,000 per spouse, with certain requirements. The portability of the gift and estate tax exemption was made permanent with the 2013 tax act so that as of this year, a couple has $10,500,000 total applicable exclusion. The GST exemption has not been made portable – yet.

C. When there is a FET, any property left to a spouse outright qualifies for the marital deduction (caveat: spouse must be a citizen of the U.S. There are special rules for a spouse who is not a U.S. citizen). Property left to a spouse in specific types of trusts <u>may</u> qualify for the marital deduction. See below. The marital deduction is unlimited in amount.

1. Leaving entire estate to spouse means there is no estate tax on the first death but can result in too much tax on the second death, as much as 50% of assets combined federal and NJ estate tax starting in 2013 left to the spouse in excess of the spouse's exemption amount.
2. Improper use of joint property, property with a beneficiary designation, and life insurance can result in too much tax on the second death by wasting some of the exemption in the first estate, even though portability continues due to the rules and limitations of portability.
3. Leaving everything to a spouse outright also wastes GST exemption since it is not portable.

C. Any property left to a charity outright qualifies for the charitable deduction. Property left in specific types of trusts for a charity or with a split interest <u>may</u> qualify for a charitable deduction based on the actuarial value of the property passing to charity. The estate tax charitable deduction is not limited in amount.

D. For deaths in 2001, tax rates were from 37% to 55%, with a 5% additional tax for estates over approximately $10,000,000 so that for large estates, the rate of tax on the entire estate was 55%. After 2001, the top estate tax rates was reduced to 50% immediately and ultimately to 35%, as shown in the above chart, and the 5% additional tax was repealed effective 1/1/02. As a result, it looks like the taxes went down but in many cases, the taxes actually went up when taking into consideration the state death tax, especially in NJ – combined rate of approximately 50%: between the federal tax at 40% allowing a deduction for the up to 16% estate tax paid to NJ so that the effective combined rate is approximately 50%.

E. Generation Skipping Transfer Tax – when applicable

1. This is an additional tax on property passing to or for someone at least 2 generations younger than donor/decedent.
2. There is a $5,250,000 exemption from the tax in the year 2013, to be allocated by the donor during life for lifetime gifts and by the executor for transfers at death. That exemption will be increased for CPI in future years.
3. There is an exclusion for payments for a "skip person" of certain educational and medical expenses paid directly to the institution or service provider under IRC §2503(e) (discussed above).

VIII. NJ ESTATE TAX

A. Even if there is no NJ Inheritance Tax (and maybe no Federal Estate Tax), there may be a NJ Estate Tax if the estate exceeds $675,000.

B. The amount of the NJ Estate Tax had been the amount of the state death tax credit allowable against the Federal Estate Tax reduced by any Transfer Inheritance Tax paid to New Jersey and death taxes paid to other states. This credit was reduced as of 1/1/02 and over the years 2002 through 2004 by 25% per year, until the credit was eliminated and replaced with a deduction starting with deaths in

2005. This elimination of the state death tax credit would have had serious impact on New Jersey revenue form this source. As a result, what New Jersey did in June of 2002 was to freeze the New Jersey estate tax to the credit amount that would have been available if the decedent died in 2001 (namely only a $675,000 exemption and full state death tax credit).

C. The rates run from 4.8% to 16%, so the tax is not insignificant as the estate gets larger.

$1,000,000 estate	approximately $33,200
$1,500,000 estate	approximately $67,000
$2,000,000 estate	approximately $99,000
$3,500,000 estate	approximately $230,000
$5,120,000 estate	approximately $400,000
$5,250,000 estate	approximately $420,800

D. Recent developments in New Jersey Estate Tax

1. the New Jersey Estate Tax does not apply to out of state real property so when calculating the tax as the old state death tax credit, it is calculated as if the out of state property is not part of the gross estate and it generated its own estate tax in that state
2. A QTIP trust includable in the estate of the second spouse for federal estate tax purposes is not taxable if the first spouse died a resident of a state other than New Jersey
3. Note: there is no New Jersey Estate Tax on a person who is not a resident of NJ and owns real property in NJ.
4. Recent case Stephenson causes great concern in the way the New Jersey Estate Tax is calculated in certain circumstances requiring great care in providing for the payment of taxes under the terms of the will/trust

IX. IMPACT OF THE RECENT FEDERAL AND NEW JERSEY ESTATE TAX LAW AND NEW JERSEY PROBATE LAW CHANGES TO THE ESTATE PLANNING PROCESS

A. Need to review all estate plan documents

1. Many estates will have NJ estate tax to pay even though there is no Federal estate tax due since the NJ exemption amount and the Federal Estate Tax exemption amount are so different
2. If an old will has a formula clause to fund a marital or charitable share and an exemption share, NJ estate tax may be due even though you thought you were eliminating all taxes – the formula must be rewritten to take into account the difference in the state and federal exemptions

B. Estate tax lien:

1. We now have a NJ estate tax lien on all assets if the gross estate exceeds $675,000
2. This includes NJ assets, other state assets, joint assets, assets passing by beneficiary designation such as life insurance and IRAs, etc.
3. The NJ tax waiver affidavit Form L-8 cannot be used to release assets passing to spouse or descendants if the estate exceeds $675,000
4. But, the NJ blanket waiver allows the executor or joint owner or beneficiary to obtain ½ of the asset immediately, and the balance after the NJ estate and inheritance tax returns are filed and the waivers issued by the Division of Taxation

C. Planning concerns and opportunities

1. Re-write formula clause in will to take into account the state and federal estate tax exemptions
2. Note that the increasing exemption could cause the entire estate to be in the exemption share so that you may have to cap the amount going into it, or put a minimum on the marital/charitable share, to avoid a skewing of the estate plan if there are different provision for the two shares, ie different current and/or remainder beneficiaries of the two shares
3. Individuals with smaller estates may be able to simplify their plans, unless a trust is desired for

other reasons, such as a second marriage, spendthrift beneficiary, creditor protection, professional management of assets, etc.

4. Consider death-bed gifts to reduce the NJ estate tax, even though they might not reduce the Federal estate tax

X. WHO SHOULD PAY THE VARIOUS TAXES, DEBTS, ADMINISTRATION EXPENSES, ETC.

A. Apportionment of taxes to beneficiaries

B. Tax assessed against certain beneficiaries

C. Payment from the residue, and therefore residuary beneficiaries under the will pay the taxes for all beneficiaries

XI. ESTATE PLANNING WITH A SPOUSE

A. Sheltering the Applicable Exclusion Amount

1. Placing assets in a trust for the spouse can give the spouse the use of the funds for life while,
2. keeping the assets out of the taxable estate of the spouse and thereby,
3. getting the benefit of two applicable exclusion amounts, i.e. a total of $1,350,000 that can pass free of New Jersey Estate Tax and possibly $10,240,000, that can pass free of federal estate tax.
4. Note: as a result of the NJ Estate Tax exemption being frozen at $675,000, the FET applicable exclusion may be used differently in the planning so that we have one trust with $675,000, exempt from both taxes, and another trust with the balance of the FET exemption amount, and a third trust with the excess over both exemptions, when there is a FET
5. Where should this applicable exclusion share go:
    a. In trust for spouse
    b. In trust for spouse and descendants
    c. In trust for descendants
    d. Outright to descendants
    e. It can go anywhere, other than outright to spouse, which would defeat the planning to use two applicable exclusions between the two deaths

B. The Marital Deduction Share

1. Property passing to the spouse outright by will, beneficiary designation or joint assets, qualify for the marital deduction.
2. Several forms of trust for the spouse may be used to qualify for the marital deduction and deferral of estate tax:
    a. Power of Appointment Trust, IRC §2056(b)(5)
        i. All income to spouse required
        ii. May allow principal as needed for health, support, maintenance and education of spouse only
        iii. nothing to anyone other than spouse as long as spouse is alive
        iv. may have 5% withdrawal power
        v. Lifetime and/or testamentary general power of appointment – right to direct distributions to another person during life or by the will of the spouse
        vi. automatically qualifies for marital deduction
    b. QTIP, qualified terminable interest property trust, IRC §2056(b)(7)
        i. All income to spouse required
        ii. May allow principal as needed for health, support, maintenance and education of spouse only
        iii. nothing to anyone other than spouse as long as spouse is alive
        iv. may have 5% withdrawal power
        v. Testamentary limited power of appointment, but no lifetime limited or general power of appointment – right to direct where the balance passes

among a specified group of permissible beneficiaries on the death of spouse by spouse's will

vi. may qualify for estate tax marital deduction if executor so elects, and may make marital deduction election in part if desired

c. Estate Trust

i. May make income and principal distributable to or for spouse (and only spouse) in the discretion of the trustee by amount and timing

ii. On death of spouse, all income and principal are added to spouse's estate

d. Disclaimer Trust

i. Will/trust provides for distribution outright to spouse but spouse exercises right to disclaim so that disclaimed portion passes into a QTIP trust for spouse

ii. Entire estate or portion, such as the marital share

iii. Note: spouse cannot have a general or limited power of appointment over a trust created as result of disclaimer

C. Shifting Assets

1. If all or most assets are owned jointly, there may be a loss of the benefit of one of the applicable exclusion amounts with married couples and it could alter the intended estate plan.
2. Assets should be split until and so that each spouse has at least the amount sheltered by the applicable exclusion amount (first for the New Jersey Estate Tax exemption of $675,000 and then the Federal Estate Tax exemption, currently $5,120,000, and maybe different in the future).
3. Also, take into account the GST exemption (currently $5,120,000) and the balance remaining to be used in the estate plan
4. This can be accomplished by an actual division of assets into separate holdings or by taking title to the asset as tenants in common
5. At the same time, make sure beneficiary designations for all life insurance, IRAs, qualified plan benefits, etc. conform with intended plan and results desired

D. Elective Share

1. In general, an individual cannot disinherit the spouse.
2. The spouse can elect to take against the will an elective share of the decedent's estate by filing a complaint within 6 months of the appointment of the executor.
3. The elective share amount is basically 1/3 of the estate reduced by debts, administration and funeral expenses, but including assets received from all sources, including those acquired prior to or during the marriage, by earnings, inheritance, gift or otherwise.
4. The elective share is first satisfied out of the surviving spouse's own assets from all sources and by property received outside the will from the decedent.
5. Value of assets placed in a qualifying trust for the spouse are valued at 1/2 the total placed in trust for purposes of satisfying the elective share amount so that a QTIP trust could be used to satisfy or defeat the elective share.
6. The elective share is not available if the spouse waives his or her right to the elective share, such as through a premarital agreement or a waiver before or during the marriage.

D. Domestic partners and civil union partners

1. For New Jersey Inheritance Tax and New Jersey Estate Tax purposes, as well as inheritance laws and income tax and other New Jersey laws, domestic partners and civil union partners are treated as spouses.
2. So long as the federal DOMA (Defense of Marriage Act) exists and is Constitutional, domestic partners and civil union partners are not treated as spouses for federal law purposes, including Federal Estate Tax and Federal Gift Tax purposes. As a result, although the marital deduction is available for NJ purposes, it is not available for federal purposes and different results are

obtained.

XII. ESTATE PLANNING WITHOUT A SPOUSE

A. Who should receive the assets
   1. children or descendants
   2. parents
   3. other friends or relatives
   4. charity

B. How should the assets pass to the beneficiaries
   1. outright – gives the beneficiary total access and control
   2. in trust
      a. income interest
      b. principal interest
      c. remainder beneficiary
      b. for example for descendants: discretionary income and principal until age 22, then all income currently and principal remains in the discretion of a trustee, right to withdraw principal one-half at ages 25 and 30
   4. life estate in property
   4. split interests with charity – below
      a. charitable remainder trusts
      b. charitable lead trusts
      c. life estate in residence or farm with remainder to charity

XIII. MORE LIFETIME GIVING AND TRUST PLANNING as part of the overall estate plan – the following are lifetime transactions and gifting vehicles that can result in substantial tax and other savings for the family as well as non-tax benefits for the family. The following assumes the FET is applicable (and likely here to stay) and that there is a need or desire to reduce the assets of the testator to save taxes on his/her death or the deaths of future beneficiaries. Also remember that we still have the New Jersey Estate Tax and New Jersey Inheritance Tax even if the FET is not applicable, which taxes are not insignificant and require planning, as well.

XIV. GST TRUSTS

A. Trust for the benefit of at least two generations - The basic concept of the GST trust is that the child's generation has the use of the funds for life, with the remainder passing to further generations without tax at the child's generation -creates a safety-net of funds for the descendants in the event they need the funds, while avoiding a second or more estate tax on these funds on a child's death to the extent he or she does not need the funds.

B. One alternative: have a single trust which could provide that during children's lives, the children receive all the income from the trust equally. The children and their descendants could also be beneficiaries of the principal of the trust in the discretion of the trustee. On the death of the last of the children, the trust would be divided into shares for the grandchildren.

C. Another alternative: provide that the income and principal of the trust are available for all grantor’s descendants as the trustee deems most advisable or beneficial, subject to maintenance, education, health and support standard or broader standard. Upon the death of the last of the children, the trust would be divided into equal shares for the grandchildren.

D. Another alternative: divide the trust initially into equal shares for the children so that each child has a share for the child and child’s descendants. Each child could receive all the income of his or her trust plus principal as needed, or the income of the trust could be given to or spent for the child and the child’s descendants as needed. Upon the death of the child, the trust would be divided into equal shares for the descendants of the child. The shares for the descendants could continue in trust or be paid out to them at specified age(s) or term of years.

E. Another alternative: multi-generation trust, continuing for each generation as the previous, with a termination date at some time or in perpetuity.

F. Holding the trust as long as possible provides the better tax result for grantor's descendants. However, consideration must be given to who the grantor wants to benefit the most from this trust and how long into the future grantor wants to control the funds.

G. Flexibility provisions:

1. grant to a descendant the power to distribute his or her share as among all of grantor's descendants other than him or herself during life (lifetime limited power of appointment)
2. Grant to a descendant the power to say in his or her will who as among a specified group is to receive the balance on the death of the descendant (testamentary limited power of appointment for each descendant)
3. give the trustee the power to grant and revoke limited and general powers of appointment or postpone distributions in the discretion of the trustee

H. GST trust can be established during grantor's lifetime or upon grantor's death - If the trust is created during life, then could fund the trust with some amount, such as up to the amount of grantor's remaining exemption from the regular gift tax and/or GST tax, and then add to it on grantor's death (or death of second of grantor and spouse) if there is any GST exemption remaining on the death of the grantor.

XV. QPRTs, GRITs, GRATs and GRUTs

A. **QUALIFIED PERSONAL RESIDENCE TRUST** (Residence GRIT or QPRT).

Description: Grantor transfers a personal residence to an irrevocable trust for a specified term of years, during which term the grantor retains the right to live in and use the residence and is required to maintain the residence. At the end of the term the residence passes to the named remainder beneficiaries, outright or in further trust.

1. The longer the term of the trust, the smaller the gift for gift tax purposes
2. Value of gift to the remainder beneficiaries for gift tax purposes depends upon
   a. age of grantor
   b. value of property transferred to trust
   c. term of trust
   d. IRS discount rate for the month of transfer (note that a low IRC §7520 rate is bad for QPRTs since the lower the rate, the higher the remainder gift)
   e. The taxable gift happens at the creation and funding of the trust and there is no further gift when the property passes to or for the remainder beneficiaries at the end of the initial term of the trust when the property is hopefully worth more than its original value at the time of the transfer
3. Benefits:
   a. Provides for a transfer of the property at greatly reduced gift and estate tax cost
   b. Allows the grantor to retain the use of the property for a term selected by the grantor
4. Caveats:
   a. Grantor must outlive the term of the QPRT to obtain the gift and estate tax benefits
   b. After the term, the Grantor no longer has the right to use the property or the proceeds of sale of the property such as to purchase a new home
   c. Remainder beneficiaries generally take the property with grantor's old cost basis for future sale and depreciation, etc. purposes
5. Examples:

   Assume the grantor is 65 years old, the residence has a value of $500,000, the IRS discount rate is 1.4% in the month of transfer as it is currently (but changes monthly, November 2012 is 1.2%)

a. If the trust has a term of 5 years, the value of the gift is $424,275

b. If the trust has a term of 8 years, the value of the gift is $375,725

c. If the trust has a term of 10 years, the value of the gift is $341,635

Note: this very low interest environment and AFR is bad for the QPRT as it results in large remainder or gift value

6. Grantor could continue to use the residence after the term of the QPRT ends by renting it back at fair market rent from the remainder beneficiaries or the continuing trust
    a. Further reduces grantor's estate by amount of rent paid
    b. Gift tax free transfers to remainder beneficiaries
        i. rent is income to beneficiaries and not deductible to grantor, but the income tax rate is historically cheaper than the gift and estate tax rates and is only on the net rent not the full amount transferred
        ii. beneficiaries may have some offsetting deductions, such as depreciation and expenses like real estate taxes, condo fees, repairs
        iii. and if the trust continues as a grantor trust, the rent is not taxable income to the grantor or beneficiaries at all

B. **NON-RESIDENCE GRIT -** Description: Grantor transfers assets, (such as stocks, bonds, cash, etc.) to an irrevocable trust for a specified term of years, during which term the grantor retains the right to receive the income (interest and dividends and rents). At the end of the term the assets remaining in the trust pass to the named remainder beneficiaries, either outright or in further trust. - So long as the remainder beneficiaries are not close family members (spouse, descendants, siblings, parents, etc.), the tax benefits and issues of the GRIT are the same as for the QPRT, described above.

C. **GRANTOR RETAINED ANNUITY TRUST (GRAT) -** Description: Grantor transfers assets, (such as stocks, bonds, cash, rental property, etc.) to an irrevocable trust for a specified term of years, during which term the grantor retains the right to receive a stream of annuity payments, namely a fixed dollar amount each year. At the end of the term the assets remaining in the trust pass to the named remainder beneficiaries, either outright or in further trust.

1. The longer the term of the trust, the smaller the gift for gift tax purposes
2. Value of gift to the remainder beneficiaries for gift tax purposes depends upon
    a. value of property transferred to trust
    b. term of trust
    c. amount of annuity
    d. IRS discount rate for the month of transfer
    e. The taxable gift happens at the creation and funding of the trust and there is no further gift when the property passes to or for the remainder beneficiaries at the end of the initial term of the trust
3. Benefits:
    a. Provides for a transfer of the property at reduced gift and estate tax cost
    b. Allows the grantor to retain an annuity from the property for a term selected by the grantor
    c. Useful method with closely held businesses to transfer interests in the business to the next generation at less than current full fair market value, and can be used even with S corporations and LLC's
    d. adjusting the term of the GRAT and the annuity amount, the gift for gift tax purposes can be very small or near 0 and the effect is to deflect the appreciation after the date of the transfer to the GRAT to the remainder

beneficiaries at little gift tax cost

4. Caveats:
   a. Grantor must outlive the term of the GRAT to obtain the gift tax benefits
   b. Remainder beneficiaries take the property with grantor's old cost basis
   c. Grantor receives the annuity amount only, regardless of the actual income or cash flow of the trust, but is taxed for income tax purposes on all income of the trust, which can be a pro or a con
   d. the trust **must** pay the annuity to the grantor even if there is no cash to pay the annuity, in which case the annuity is paid in assets of the value equal to the required annuity, but since this is a grantor trust, there is no adverse income tax consequence to the distribution of an asset of the trust in payment of the required annuity
   d. The Grantor has no access to excess income or principal
   e. After the end of the term of the GRAT, the grantor no longer receives any income or principal from the assets
   f. Current discussions in Congress: impose a minimum term on GRATs to avoid use of short term GRATs, and impose a minimum remainder interest for the remainder beneficiaries to prevent nominal gifts. Congress has tried this a few times and so far it has not passed but they still on their plate of revenue raisers and “abuse busters”.

5. Examples:

Assume the assets transferred to the trust have a value of $500,000, the IRS discount rate is 1.4% in the month of transfer, and the GRAT pays an annuity of $25,000 per year (5% of the initial value of the trust)

   a. If the trust has a term of 5 years, the value of the gift is $385,167
   b. If the trust has a term of 8 years, the value of the gift is $325,560
   c. If the trust has a term of 10 years, the value of the gift is $307,322

NOTE: The leverage is greater with the QPRT than the GRAT

D**.** **GRUT -** Description: Grantor transfers assets, (such as stocks, bonds, cash, rental property, etc.) to an irrevocable trust for a specified term of years, during which term the grantor retains the right to receive a stream of payments equal to a percentage of the value of the trust assets determined each year. At the end of the term the assets remaining in the trust pass to the named remainder beneficiaries, either outright or in further trust. This has the same pros and cons as the GRAT for tax purposes, but gives the grantor a protection against inflation since the distributions are a percent of value, not a fixed dollar amount, which impacts the amount of the gift to remainderpersons. Caveat: this technique requires annual valuation of the assets of the trust which can be problematic with hard to value assets, such as closely held business interests and real estate.

E. QPRTs, GRITs, GRATs and GRUTs may serve to **leverage** the gift tax exemption and rates due to deferred gift to the beneficiaries and retained rights in grantor, while allowing the grantor to retain specified rights in the property and the use of the property or its income for a term of years

F. In using these trusts, **selecting the term** is difficult. The goal is to choose the longest term possible with such term ending prior to the grantor's death. If the grantor lives beyond the term of the QPRT, GRIT, GRAT or GRUT, then the grantor has succeeded in getting property out of his or her estate at the greatly reduced federal gift and estate tax cost. If the grantor dies before the end of the term, then the property is back in the grantor's estate as if the grantor had done nothing, so this is basically a win/no lose situation.

XVI. LIFE INSURANCE

A. QUESTIONS TO ASK REGARDING LIFE INSURANCE COVERAGE

1. Who is the owner, insured and beneficiary of the insurance
2. Is there sufficient insurance on the wage-earner spouse to protect the other spouse and children for the future
3. Is there a need for insurance on the non-wage-earner spouse, to assist the other spouse with the cost of child-care and other services provided by the deceased spouse
4. Is there a need for liquidity, such as in an estate including substantial real property or closely held business interests
5. Is there a desire to replace for the family some of the wealth that will be lost to taxes, debts and expenses

B. THE IRREVOCABLE LIFE INSURANCE TRUST (ILIT)

1. If life insurance is owned by an ILIT and the ILIT is the beneficiary of the insurance, if certain formalities are respected and the insured lives more than three years after the transfer of the policy to the trust, then the insurance should not be subject to estate tax in the estate of the insured or spouse, even though the funds are available for the spouse and ultimately pass to the descendants tax free
2. The trust agreement must give to a specified group of individuals the right to withdraw certain amounts as additions are made to the trust to pay the premiums on the insurance, and notices of such right (Crummey notices) must be sent to the said beneficiaries to shelter the additions with the annual gift tax exclusions for the beneficiaries of the trust
3. The Crummey beneficiaries must be at least contingent remainderpersons, namely they must have some possibility of receiving benefits later
4. If a new policy is used, and the trust is the applicant for the insurance as well as the owner and beneficiary, we avoid the three year wait for the trust to be tax effective
5. The proceeds are available to the estate to assist with the payment of debts, taxes and expenses through a loan from the trust to the estate or a purchase of estate assets by the trust
6. Through the use of the ILIT, it is as if the insured was to create additional applicable exclusion amounts since the proceeds are not taxable in the insured's estate and the insured's estate still has the full applicable exclusion to shelter probate and non-probate assets that are taxable in the estate
7. A gift tax return should be filed each year additions are made to the ILIT or premiums are paid for the ILIT even if the premiums are within the federal gift tax annual exclusion to affirmatively elect in or out of the allocation of GST exemption where there is any possibility of a generation skip to avoid the uncertainty of a deemed allocation of GST exemption to the trust

XVII. IRAs, IRC §401(K) and QUALIFIED PLAN BENEFITS

A. The IRA or plan benefits pass by beneficiary designation, not by the terms of the will or trust (unless the benefits are payable to the estate by beneficiary designation)

B. The IRA or plan benefits are taxable for

1. federal and NJ estate and NJ inheritance tax purposes to the plan owner's estate, and
2. income tax purposes to the beneficiary as withdrawn from the plan
3. eligible for an IRC §691 income tax deduction for the portion of the federal estate tax attributable to the benefits withdrawn in that year that were subject to Federal Estate Tax in the decedent's estate

4. making this the most expensive asset

C. Spouse as beneficiary:
   1. Spouse has a choice of taking the benefits outright and paying the income tax immediately,
   2. taking the benefits over a period of up to 5 years or his/her lifetime, or
   3. rolling the benefits over to an IRA for the spouse, subject to all the regular IRA rules as if the spouse were the participant in the plan,
   4. paying income tax each year only on the amount withdrawn that year

D. Beneficiary other than the spouse as beneficiary:
   1. Beneficiary may take the benefits outright and pay the income tax immediately,
   2. may treat the IRA or plan as an inherited IRA and then choose to take the benefits out over a period not to exceed 5 years or over the beneficiary's lifetime, with certain limitations – if the participant was in pay status (older than 70 ½) then over the participant's remaining life expectancy
   3. paying income tax each year only on the amount withdrawn that year
   4. but the estate and inheritance tax are still due 9 and 8 months after the participant's death even if the inherited IRA is selected

E. Trust as designated beneficiary:
   1. If the benefits are paid in a lump sum to a trust, the income tax is due on the full amount of the benefits in the year of payment
   2. even if the beneficiary designation says pay in a lump sum to the trust, the trustee may be able to spread the payments out over a period of up to 5 years to save some income tax
   3. If the beneficiary is a QTIP trust for the benefit of the spouse, the benefits may be payable over the lifetime of the spouse of the greater of the actual income earned in the IRA or plan and the minimum required distribution for the spouse, thereby obtaining income and estate tax deferrals and protection of the assets for the spouse and remainder beneficiaries if the beneficiary designation properly provides for this lifetime payout
   4. if the benefits are paid to a trust for a single beneficiary over the lifetime of the beneficiary with provisions in the trust and beneficiary designation that qualify the trust as a conduit trust, then a trust may be used for any beneficiary
   5. using a trust as a beneficiary requires careful planning and drafting, and the coordination of the beneficiary designation and trust provisions

F. Charity as beneficiary of the IRA or qualified plan
   1. Charity may be the beneficiary of an IRA or qualified plan
      a. The entire IRA or plan may be payable to the charity(ies)
      b. A fraction or percent of the IRA or plan may be payable to the charity(ies)
      c. The estate does not pay any estate or inheritance tax on portion passing to charity(ies)
      d. The charity(ies) pay no income tax on the benefits received
      e. The cost to the family is small considering the estate, inheritance, GST, and income taxes saved by the charitable gift since the family could net as little as 20% of the benefits after taxes while charity keeps the entire (100%) of the benefits.

   2. Charitable remainder trust (see XXI below) as beneficiary of IRA or qualified plan

a. The benefits could be payable to a CRUT for the benefit of a spouse or child of decedent or another individual, giving the individual beneficiary a stream of payments for life, with the remainder passing to charity(ies) on the death of the individual beneficiary
b. Decedent's estate has an estate tax charitable deduction for the actuarial value of the remainder that will pass to charity(ies) on the death of the beneficiary, resulting in potentially a substantial saving of estate tax on the IRA/plan owner's death
c. The CRUT pays no federal income tax, including upon the original distribution of the lump sum of the IRA/plan to the CRUT by beneficiary designation as well as in the income earned each year of the trust's existence, so that the assets grow faster in the trust
d. The CRUT does pay NJ income tax on the income not distributed to the beneficiary since it is not a wholly charitable trust
e. The beneficiary pays income tax on distributions from the trust, but at most on the amount distributed each year, not on income retained in the trust
f. The trust serves as creditor protection and spendthrift protection for the individual beneficiary during his/her lifetime

3. Charitable distributions direct from an IRA - Qualified Charitable Distribution or QCD
a. This has been extended through 2013 only so far
b. Qualified direct distributions from an IRA to a charity are not considered taxable income to the IRA owner and not deductible as a charitable gift by the IRA owner
c. Must come from IRA only (not employer sponsored retirement plans, SIMPLE IRAs or SEPs
d. Maximum amount: $100,000 per year
e. IRA owner must be at least 70 ½ years old
f. Qualified charities: public charities as defined in §170(c)(1)(A) other than support organizations and donor advised funds
g. qualifies to be treated as all or part of the minimum required distribution of the IRA owner for the year
h. The QCD is better than a withdrawal from the IRA and then contribution because the QCD is not included in the taxable income with a deduction since the deduction may not fully offset the income due to things such as charitable deduction limitations, partial disallowance of excess itemized deductions for high income earners, AMT, etc.

XVIII. DEFECTIVE GRANTOR TRUST

A. DESCRIPTION OF BASIC TERMS

1. This is a trust for the benefit of someone other than the grantor which includes an administrative provision so that the income in the trust is taxable to the grantor of the trust even though the grantor has no rights to any income or assets of the trust
2. Irrevocable gift in trust, with no specific required provisions as to income or principal
3. The transfer to the trust is a taxable gift at the value of the assets transferred to the trust
a. The transfer does not qualify for the gift tax annual exclusion unless special powers or provisions are included, such as Crummey withdrawal powers (right to withdraw additions to the trust up to the greater of 5% or $5,000 and notice of such additions)

b. The appreciation or growth in the assets and the income generated by the assets between the date of gift and grantor's death is excluded from grantor's estate

4. Income taxable to grantor includes ordinary income (interest, dividends, rents, royalties) and capital gains
5. Payment of the income tax by the grantor has the effect of being a gift-tax-free addition to the trust while reducing the grantor's estate
6. Caveats:
    a. Exposure of the grantor for income tax can be substantial possibly without a source of funds to pay the tax (but the grantor might be able to release the power making it a grantor trust for future years making future income taxable to the trust or its beneficiaries in place of the grantor)
    b. Assets in the trust have the grantor's old cost basis

B. EXAMPLES

1. The trust could be initially divided into equal shares for the grantor's children, with the child receiving the income from his or her trust and principal as needed. The trust could also provide for distributions to or for the child's descendants as needed. Then, the child could have the power to withdraw his or her trust share at a specified age or ages.
2. Generation skipping uses of the defective grantor trust
    a. See Part XIV for a description of GST planning and choices
    b. The defective grantor trust provides especially powerful leverage when used as a GST trust, multiplying the benefits for future generations
    c. Note: NJ repealed the Rule against Perpetuities so that multiple generations can be included in the GST trust

C. SALE TO DGT

1. Transactions between a grantor and the grantor’s grantor trust are disregarded for income tax purposes
2. As a result, a sale from a grantor to the grantor’s DGT does not result in any gain (or loss) recognition on the transaction
3. This allows the grantor to freeze the value of assets and deflect future growth in the assets to the beneficiaries of the DGT
4. Similarly, in a QPRT, if after the initial term the trust continues for the benefit of the grantor’s family as a grantor trust, the lease between the trust and the grantor results in no income tax on the lease payments

XIX. FAMILY LIMITED PARTNERSHIPS (AND LIMITED LIABILITY COMPANIES)

A. REASONS TO USE THE FLP or LLC

1. The use of the partnership could provide various protections against creditors to the family and its assets, including judgment creditors and professional liability as well as potential former spouses.
2. The use of the partnership or LLC would allow a group of individuals to consolidate holdings into one entity, making management easier for the future.
3. The partnership/LLC could be used as a financial training tool for the younger members of the family.
4. The partnership/LLC can provide a simplified method for the family to invest and manage investments together.
5. The entity can keep the family together since they have to work together on the entity issues and manage the investments together.
6. With a larger pool of investible assets, the parties may be able to pursue better investment opportunities and achieve superior investment results, including being able to invest in certain funds that require a relatively high minimum

investment.

7. The partnership/LLC may also be used to make gifts to other members of the family in a simplified manner, giving each recipient an interest in many assets through the gift of just one, namely a percentage interest in the partnership/LLC, which holds many assets.
8. The gift can be made without the recipient obtaining total control over the gifted asset.
9. The partnership/LLC may also allow the donor to transfer more value to his or her children and grandchildren during lifetime at reduced gift tax cost and potentially reduce the estate tax on the interest in the partnership/LLC remaining in the decedent's name at the date of death through the use of discounts in valuation available for lack of marketability, lack of control, illiquidity of the interest and/or underlying assets, etc.

B. STRUCTURE OF FLP

1. General partner: individual or S corporation or LLC, the party with the control over the day to day management and operations of the entity
2. Limited partners: individuals, trusts, or other entities with no voice or control over the entity and its assets
3. Individual becomes partner by making a contribution of assets to the FLP in exchange for a partnership interest
4. Partnership Agreement controls management of assets, distributions to partners, and the ability of a partner to transfer a partnership interest
5. Only the general partner may participate in management
6. The general partner has unlimited personal liability while the limited partners enjoy limited liability

C. STRUCTURE OF LLC

1. Managing member: individual and/or other entity, or committee
   a. the party with the control over the day to day management and operations of the entity
   b. could be a committee, not just one party
2. Other members of the LLC: individuals, trusts or other entities with as much voice or control over the entity and its assets as provided in the operating agreement for the LLC
3. Party becomes member by making a contribution of assets to the LLC in exchange for a membership interest
4. Operating Agreement controls management of assets, distributions to members, and the ability of a member to transfer a membership interest
5. All members may participate in management
6. All members have the benefit of limited liability

D. USE OF FLP AND LLC IN GIFTING

1. Outright gift
2. To a trust for beneficiary/ies
3. Sale
   a. to individual
   b. to a trust for beneficiaries
   c. to a defective grantor trust

E. **Caveat**: IRS target at the time of the gift of an interest in the FLP or LLC and on the death of a partner or member

1. Valuation issues, mostly, but also an issue re the annual exclusion
2. Target of IRS, especially when the entity only has marketable securities and substantial discounts are taken in valuation
3. Recent cases and estate tax audit settlements shed new light on what not to do in structuring the FLP or LLC
4. Keys to success of this strategy:
    a. Proper organization and operation of the entity
    b. The senior generation should not be the general partner or manager, or even have a piece of the general partner or manager or other control over the entity
    c. Respect the organizational structure – operate and administer the entity as a business and not as the personal account of the senior generation
    d. Do not put personal use assets in the entity, unless there will be rental arrangement (i.e. residence of senior party)
    e. Do not put all the assets of the senior generation in the entity, but make sure there are sufficient assets outside the entity for the senior to live and pay his/her own expenses and taxes, including future estate taxes
    f. Do not make unsecured loans to family members
    g. Do not make disproportional distributions from the entity
    h. Do not pay the personal expenses of the senior generation from the entity, but let the senior pay his/her own expenses from other assets or from the proportional distributions from the entity
    i. The timing of distributions should not match the timing of expenses of the senior generation
    j. No post mortem or post transaction accounting maneuvers
    k. Do not terminate the entity as soon as the senior generation dies
    l. Do not pay the estate tax on the estate of a senior from the entity

XX. SOME CHARITABLE TRUSTS TO CONSIDER

A. GIFTS CURRENTLY ENJOYED BY CHARITY.

1. **Charitable Lead Trust**.
    a. A charitable lead trust is a trust from which a charity (or charities) receives a fixed dollar amount (annuity) or a fixed percentage of the net fair market value of the trust assets (unitrust) annually, and upon the end of a term of years or upon the death of an individual, the remainder passes to the donor, donor's spouse or descendants or other non-charitable beneficiaries.
    b. Certain requirements.
        i. There is no minimum percentage that must be paid to charity if the trust payment is in the form of an annuity (fixed dollar amount) or unitrust (fixed percentage of the value in the trust) amount. However, the amount must be paid at least annually to the charity(ies).
        ii The trust cannot provide that the charity is to receive all the income, or any other provisions other than an annuity or unitrust to obtain the income, gift and estate tax benefits of the CLT.
        iii. The term of the trust may be for any number of years or may be measured by the life or lives of individuals alive at creation of the trust.
        iv The trust agreement must contain specific provisions and private foundation rules.
    c. Income Tax Aspects.

i. The donor is allowed an income tax deduction for the value of the charity's annuity or unitrust interest on the date of funding of the trust, but only if the trust is considered a grantor trust. The deduction is limited to 20% of the donor's contribution base as it is a gift "for the use of" and not "to" charity, and no carryover is permitted.

ii. If the trust qualifies for the income tax charitable deduction as a grantor trust, then any taxable income of the trust is taxable to the donor as it is earned, in effect recapturing the deduction.

iii. If the trust is a testamentary trust or is not a grantor trust, undistributed income is taxed to the trust, and there is no income tax deduction for the grantor in the year of the funding.

iv. Under the grantor trust rules, if the assets of the trust revert to the grantor or the grantor's spouse at any time (if the value of the reversion is at least 5% of the value at the time of the transfer), the trust is considered a grantor trust.

v. The longer the term of the trust, or the larger the annuity or unitrust amount, the larger the amount the current income tax deduction will be.

d. Gift Tax Aspects.

i. A gift tax charitable deduction is allowed in the amount of the actuarial value of the annuity interest or unitrust interest. The value is determined by the dollar annuity or percentage unitrust amount and the term of years or life expectancy using the IRS tables and IRC §7520 rates.

ii. The value of the remainder is a taxable gift, not eligible for the $13,000 ($14,000 starting 1/1/13) annual gift tax exclusion as it is a future interest. The remainder passing to a spouse qualifies for the gift tax marital deduction. The value of the remainder is the value of the entire transfer to the trust reduced by the value of the charitable annuity or unitrust interest.

e. Estate Tax Aspects.

i. The estate tax charitable deduction is allowed in the amount of the value of the annuity interest or unitrust interest established in a testamentary CLT, calculated as described above in d.

ii. If the remainder passes to a spouse, that gift qualifies for the estate tax marital deduction under

f. Advantages of CLT.

i. The CLT permits the transfer of assets to the non-charity beneficiaries at a later date with a greatly reduced estate or gift tax cost, i.e. for minor children or grandchildren.

ii. The lifetime CLT is useful to an individual who has high income tax in the year of the transfer to the CLT and not in the future, i.e. retiree, or someone with a large capital gain in a given year and lower income in the future, since it produces an income tax deduction in the year of the transfer to the trust and taxable income in later years.

2. **Charitable Gift Annuity**: If the donor purchases an annuity from a charitable organization, the donor is allowed charitable income and gift tax deductions for the excess of the amount paid for the annuity over the value of the annuity. If a gift annuity is provided for a beneficiary upon the death of the donor, an estate tax charitable deduction is available. If there is no excess, there is no

deduction.

B. **DEFERRED GIFTS TO CHARITY**

There are several types of split interest remainder transfers to charity which qualify for the income, gift and estate tax charitable deduction. If the transfer is not in one of the specified forms, no charitable deduction will be allowed, even though there is an actual transfer to a charity at some time. These forms include the following: remainder interest in personal residence or farm, remainder interest in pooled income funds, remainder interest in charitable remainder annuity trusts and unitrusts, and private foundations.

1. **Pooled Income Funds**.
   a. A pooled income fund is an investment fund created and maintained by a public charity (i.e. educational institution, religious organization, hospital) which consists of property contributed by more than one donor which is commingled. Each donor transfers property to the PIF and either retains in himself or herself and/or creates for another individual a life income interest therein, thereby creating a charitable remainder interest. All property so transferred is invested together. Each donor (or donor's designated life income beneficiary) receives the pro rata share of the income of the PIF each year for life. On the death of the income beneficiary, the charity withdraws the donor's share of assets from the PIF and uses them for its charitable purposes.
   b. Certain Requirements.
      i. The transfer to the PIF creates an irrevocable remainder interest in a charity.
      ii. Donor either retains for himself or herself or creates for another individual(s), who is alive at the time of the transfer, a life interest in the income of the PIF.
      iii. All property in the PIF is commingled with property transferred by other donors.
      iv. Neither the transferred property nor investments by the fund may include tax exempt securities.
      v. The fund must be maintained by the same charity to or for the use of which the remainder interest is contributed.
      vi. No donor or beneficiary may be a trustee of the fund.
   c. Income Tax Aspects.
      i. The donor is allowed a charitable income tax deduction in the amount of the value of the remainder interest based on the age of the income beneficiary and actuarial tables found in the Regulations.
      ii. The donor does not recognize any capital gain upon transferring appreciated non-mortgaged assets to the PIF. The fund takes the property with the donor's basis and holding period.
   d. Gift Tax Aspects.
      i. The transfer to a PIF has two components, namely the gift of the income interest and the gift of the remainder interest to charity, calculated based on the age of the income beneficiary and the tables in the month of the transfer.
      ii. The value of the charitable remainder is deductible for gift tax purposes.
      iii. The value of the income interest is a taxable gift eligible for the $13,000 ($14,000 starting 1/1/13) annual gift tax exclusion. If the donor is the income beneficiary, there is no taxable gift. If the

donor's spouse is the income beneficiary, the donor may elect to qualify this as QTIP property for the gift tax marital deduction.

e. Estate Tax Aspects.

i. Transfer inter vivos

(a) If the donor was the sole income beneficiary, the value of the fund is includible in the donor's gross estate. The estate then receives a charitable deduction for the full value of the fund passing to charity.

(b) If the income beneficiary is other than the donor, the fund is not includible in the gross estate but there was an adjusted taxable gift at the time the trust was created and funded.

(c) If the donor retained the income interest and on donor's death the income interest goes to another income beneficiary, then the fund is includible in the donor's gross estate under and the estate is entitled to a charitable deduction in the amount of the value of the charitable remainder after the death of the second beneficiary (or the entire amount if the second income beneficiary does not survive the donor).

(d) The marital deduction is available where the spouse is the income beneficiary, if the decedent or the decedent's executor makes the election for this QTIP property.

ii. Testamentary transfer:

(a) The amount of the devise to the PIF is includible in the gross estate and the estate is entitled to a charitable deduction in the amount of the value of the charitable remainder taking into consideration the life interest of the income beneficiary.

(b) If the spouse is the income beneficiary, the executor can make the QTIP election to get the marital deduction. On the spouse's death, the fund is included in the spouse's estate and then deducted as a charitable contribution.

2. **Charitable Remainder Annuity Trust and Unitrust**.

a. A charitable remainder annuity trust or unitrust is a trust from which a non-charitable beneficiary receives a fixed dollar amount (not less than 5% nor more than 50% of the initial fair market value of the transferred property) (annuity) or a fixed percentage (not less than 5% nor more than 50%) of the net fair market value of the trust assets (unitrust) annually, and upon the death of the income beneficiary, or after the specified term of years, charity(ies) receives the remainder of the trust.

b. The unitrust may provide that the trustee pay the smaller of the actual trust income or the unitrust amount ("NI-CRUT").

i. The trust may also provide that any deficiencies so created, when the income is less than the specified unitrust percentage, may be made up in later years ("NIM-CRUT").

ii. The trust may flip from one type to another, or combine methods of determining the unitrust amount, if certain criteria are met, as provided in the Regulations.

c. Certain Requirements.

i. A sum certain, in the case of an annuity trust, or a specific percentage of the trust assets valued each year, in the case of a unitrust, must be designated as payable at least annually to a non-charitable beneficiary(ies) living at the time the trust is created for the life (lives) of the beneficiary or a term of years (not in excess of 20 years).

ii. The sum cannot be less than 5% nor more than 50% of the initial fair market value of all assets placed in trust for an annuity trust, or must be a stated percentage of at least 5% of the fair market value of the trust assets valued annually for a unitrust.

iii. The remainder must have an actuarial value of at least 10% of the value of the assets transferred to the trust.

iv. The remainder must be transferred to, or for the use of, qualified charitable organization(s), or retained by the trust for such use. No part of the remainder can go to or for anyone other than a charity.

v. The trust must provide that if at the time of distribution the remainder organization is not a qualified charitable organization, the remainder is to be paid to one or more alternative qualified charitable organizations.

vi. No amounts other than the specified annuity or unitrust may be paid to or for the use of anyone other than a charitable organization. No invasions of principal for the benefit of the non-charitable beneficiaries are permitted, except those contemplated by the annuity or unitrust.

vii. No additions are permitted to an annuity trust. Unitrust governing instruments must either prohibit additions or make specific provisions therefor.

d. Income Tax Aspects.

i. The remainder trust is exempt from federal income tax on the income earned in the trust. The CRT is not exempt from NJ income tax since it is not a wholly charitable trust but the trust is not taxed on amount distributed to the beneficiary.

ii. Distributions to beneficiaries retain the income tax character to the beneficiary as such sums had to the trust and are taxable to the receiving beneficiary even though the income would not have been taxed in the trust. Distributions to non-charitable beneficiaries are characterized in the following order of priority:

(a) First, ordinary income to the extent the trust has ordinary income for the year and undistributed ordinary income for prior years;

(b) Next, capital gain to the extent the trust has capital gains for the year and undistributed capital gains for prior years;

(c) Next, other income to the extent of the trust's other income for the current year and undistributed income for prior years;

(d) Lastly, tax-free distribution of trust corpus.

iii. It the trust is established during the life of the donor, an income tax charitable deduction is allowed to the donor in the amount of the value of the remainder interest, calculated actuarially based on the age of the income beneficiary or the term of years, percentage unitrust or annuity, IRS discount rate for the month of the transfer, all in accordance with the Regulations.

(a) If the remainder beneficiary is a 50% charity, the 50% income tax charitable deduction ceiling applies if the remainder is distributed to the charity and not held in further trust for the charity.

iv. The donor does not recognize any capital gain on the transfer of appreciated property to the trust.

v. No capital gain is recognized by the donor on a subsequent sale of assets by the trust unless assets are sold and the proceeds are invested in tax exempt securities pursuant to an express or implied agreement between the donor and the trustee.

e. Gift Tax Aspects of a lifetime CRT.

i. As with a pooled income fund, the donor makes two gifts: the income interest and the remainder interest to charity, calculated actuarially based on the age of the income beneficiary or term of years and the IRS tables.

ii. The value of the charitable remainder is deductible.

iii. The value of the income interest is a taxable gift eligible for the $13,000 annual gift tax exclusion. If the donor is the income beneficiary, there is no taxable gift. If the donor's spouse is the sole income beneficiary other than the donor, the gift qualifies for the gift tax marital deduction.

f. Estate Tax Aspects.

i. Inter vivos trust

(a) If the donor was the sole income beneficiary, the value of the trust assets is includible in the donor's gross estate. The estate then receives a charitable deduction for the full value of the trust assets.

(b) If the income beneficiary is other than the donor, the trust is not includible in the donor's gross estate but there was an adjusted taxable gift upon creation and funding of the CRT.

(c) If the donor retained the income interest and on the donor's death the income interest goes to another lifetime beneficiary, the value of the trust assets is includible in the donor's gross estate. If the second income beneficiary has not survived the donor, the full amount of the trust assets is deductible. If the second income beneficiary survives the donor, the estate has a deduction in the amount of the value of the remainder based on the age of the income beneficiary or the term of years and the amount of the annuity or percentage unitrust. If the second income beneficiary is the donor's spouse, the marital deduction is allowed for the assets in the trust.

ii. Testamentary Trust: If the trust is created by the donor's will or at donor's death, the donor's estate is entitled to a charitable deduction in the amount of the value of the remainder interest based upon the age of the income beneficiary or term of years and the amount of the annuity or percentage unitrust. If the donor's spouse is the income beneficiary the marital deduction is allowed for such income interest.

3. **<u>QTIP Trust with Remainder to Charity</u>**.

a. A QTIP trust with a remainder to charity does not qualify for the income, gift or estate tax charitable deduction for the donor. However, if the donor (inter vivos) or the donor's executor (testamentary), makes the QTIP election, the full value of the trust (or the portion so elected) would qualify for the gift or estate tax marital deduction, which defers the tax until the death of the second spouse. On the death of the second spouse, the assets are included in the spouse's estate, but that estate is allowed a charitable deduction for the remainder as property passing to a charity.

b. Advantages of QTIP.
    i. The surviving spouse will receive all the income of the trust, not just the annuity or unitrust amount.
    ii. The principal of the trust may be invaded for the benefit of the spouse.
    iii. The trust document is simpler to draft and the trust is simpler to administer.
    iv. The remainder can be split among charitable and non-charitable beneficiaries.

c. Disadvantages of QTIP.
    i. A qualified charitable remainder trust is a federal income tax exempt entity and pays no federal income tax on income not distributed to the income beneficiary, but a QTIP is subject to tax on capital gain and the spouse pays income tax on all ordinary taxable income.
    ii. No income tax deduction is available upon the creation of the QTIP with remainder to charity.
    iii. If the QTIP election is made, the value of the trust assets is included in the surviving spouse's estate, which could have an impact on special use valuation, extension of time to pay taxes, or a redemption of stock due to percentage limitations, and other matters relating to the gross and taxable estate of the second spouse.

4. **<u>Private Foundation</u>**

a. The typical private foundation is established by the donor as a trust or non profit corporation which satisfies the requirements of IRC §501(c)(3) with respect to purposes but whose support is limited in the number and type of donors so as not to meet the IRC §509(a) public support tests.

b. There are many types of Private Foundations.

c. There are very strict rules that must be observed in the operation of a Private Foundation, i.e. no self dealing, minimum distributions, no excess business holdings, etc.

d. Donor obtains an income and gift or estate tax deduction up front and the funds are paid out to charity or charities over many years.

e. Donor and donor’s designees retain control over the assets and the distributions to charities over the life of the foundation

f. Creating and funding or addition to Private Foundations are useful in the year of high income where the donor does not want to decide which charities to give to or does not want to give the full amount in year one.

5. Special uses of CRTs and Private Foundations

a. Appreciated property
    i. Sale and donation of proceeds vs. donation of property and sale by CRT or PF
    ii. Since the CRT and PF are exempt from federal income tax,

when the asset is sold, the entire proceeds remain in the entity for reinvestment. Caveat: the CRT is subject to income tax for NJ income tax purposes.

iii. Useful for diversification of holdings

iv. Convert low basis/low income assets into higher yielding assets for increased cash flow

b. Large qualified employee benefits or IRA

i. If the individual has substantial qualified employee benefits, the family may net as little as 20% after estate, inheritance, GST, income, etc. taxes

ii. If there is any charitable intent, this is a very good source for such bequest

iii. All or a portion of the qualified benefits passing to charity outright on death by beneficiary designation

(a) No estate or inheritance tax, and

(b) Charity pays no federal income tax, but does pay NJ income tax

iv. All or a portion passing to the CRT

(a) Depending on the age of the individual beneficiary and the amount of the annuity or unitrust, the estate tax deduction may be substantial

(b) CRT pays no federal income tax on benefits received and reinvests the entire amount less the NJ income tax

(c) Since the CRT pays no federal income tax, the annuity or unitrust payments may be more than an outright payment in just a couple of years, and if the individual(s) live a long time, the additional amounts may be substantial - the beneficiaries and charities get more and only the IRS gets less

6. Community Foundation and donor directed funds – as a great alternative to the use of a private foundation for smaller sums or for families who want to have someone else perform the administrative duties while the family continues to be able to decide on the recipients of grants. Public type, such as the Community Foundation of New Jersey or private such as Fidelity Charitable

XXII. AFTER THE DEATH OF A SPOUSE

A. Settling the spouse's estate – this shows the need to be involved in the planning

1. Assembling the assets – what are they, where are they, value, how owned – is there a master list of assets, debts, mortgages, advisors, etc.
2. Debts, liabilities, expenses of administering the estate
3. Understanding the dispositive scheme and where the assets pass upon death
4. Disclaimers
5. Tax decisions and elections – ie. estate tax vs. income tax

B. Administering the trusts established by the deceased spouse

1. Understanding the terms of the will, trust, beneficiary designations
2. Proper investment management
3. Proper distributions
4. Exercise of any powers of appointment

C. The professional advisory team

1. attorney
2. accountant
3. investment advisor(s)

4. insurance professional

Caveat: All the above discussion of the availability of the marital deduction is dependent upon the surviving spouse being a U.S. citizen. Special provisions must be made for a spouse who is not a U.S. citizen for a transfer to or for a spouse to be eligible for the marital deduction.

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