

## TRUSTS & ESTATES

### NEW JERSEY REPEALS ITS ESTATE TAX

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Reports of its demise were not greatly exaggerated. After months of speculation and several fits and starts, New Jersey has repealed its estate tax as part of a legislative compromise to fund New Jersey's Transportation Trust Fund by increasing the gas tax.

#### Overview

The federal estate tax exemption presently is \$5.45 million, and is indexed annually for inflation. In contrast, New Jersey's estate tax exemption has been stuck at \$675,000 for the past 15 years. Because New Jersey's estate tax exemption has been so low, many New Jersey residents have moved out of New Jersey, or have considered doing so, to one of the roughly three dozen states that impose no estate tax.

Once New Jersey's estate tax repeal is fully phased in (more about that below), residents will no longer need to flee the state to avoid New Jersey estate tax. Indeed, we anticipate that some former New Jersey residents will return, and that individuals who live in neighboring states that still impose estate tax, such as New York and Pennsylvania, may consider moving to the Garden State.

#### Let's go over some questions you may have about this important development.

#### What are the details of the estate tax repeal?

New Jersey's estate tax repeal takes full effect on January 1, 2018. A New Jersey resident who dies on or after that date will not be subject to New Jersey estate

tax. A New Jersey resident who dies in 2017 will be subject to New Jersey estate tax, but will have a \$2 million (rather than \$675,000) exemption. The \$675,000 exemption will continue to apply to any New Jersey resident who dies before January 1, 2017.

#### I read that New York recently made favorable changes to its estate tax laws. Is New Jersey's new legislation any different?

New Jersey's estate tax repeal is considerably more taxpayer-friendly than other states, including New York, that merely match the federal estate tax exemption. For example, in New York the estate tax exemption vanishes for decedents whose estates exceed 105% of the federal exemption amount. In contrast, beginning in 2018 New Jersey will not impose estate tax on any estate, regardless of its value.

For example, assume that by 2018, when New Jersey's estate tax is fully repealed, the inflation-adjusted federal estate tax exemption has risen to \$5.6 million. Joe dies, leaving his entire \$6 million estate to his children. Joe's estate will not owe any New Jersey estate tax. In contrast, if Joe had lived in New York, his estate would be subject to a \$510,800 New York estate tax. (Note: Because state estate taxes are deductible for federal estate tax purposes, if Joe had lived in New York the net cost to Joe's estate would be somewhat less than \$510,800.) Thus, some New Yorkers can achieve meaningful estate tax savings by moving to New Jersey.

#### Does the new legislation mean I can ignore New Jersey "death taxes" when doing my estate planning?

Not necessarily. Although New Jersey has repealed its estate tax, New Jersey's inheritance tax remains in place. Unlike the estate tax, which is based on the size of the decedent's estate, New Jersey's inheritance tax is based on the relationship of the decedent to the beneficiary. Bequests to charities and many close family members (e.g., a spouse, domestic partner, descendant, or ancestor) are not subject to inheritance tax, but bequests to friends and certain relatives (e.g., a sibling, cousin, niece or nephew) are subject to inheritance tax, at rates that quickly reach 16%. Thus, anyone who intends to make a gift at death that would trigger an inheritance tax still should consider planning techniques that can reduce or eliminate that tax.

#### Can you give me an example of how the estate tax repeal may impact my existing estate plan?

Many well-crafted estate plans create trusts for tax (as well as nontax) reasons. For New Jersey residents, that often meant funding a testamentary trust for the surviving spouse's benefit with at least \$675,000 in assets. Such trusts enabled couples to double the amount that could pass to beneficiaries free of New Jersey estate tax upon the surviving spouse's death. Now, those so-called "credit shelter" trusts may create unnecessary administrative complexity and expense. Moreover,

those trusts may actually **increase** the income tax burden faced by families, as trust assets will not receive a “stepped-up” tax basis when the surviving spouse dies.

Some individuals now may be able to reduce complexity, reduce ongoing post-death costs, and generate income tax savings by modifying their estate plan to eliminate certain trusts. Others should modify their estate plans, not to eliminate trusts but rather to decouple the amount currently placed into trust by formulas tied to New Jersey’s estate tax exemption amount.

In addition, because New Jersey’s estate tax remains in place until January 1, 2018, estate plans should account for the possibility that an individual may die before that date. Failure to do so could produce hundreds of thousands of dollars of unnecessary taxes. For example, a married couple with a net worth of \$25 million might have wills that leave the maximum federal estate tax exemption (\$5.45 million) to their children upon the first spouse’s death, on the theory that the surviving spouse will not need that money. Such a plan often made sense in the past, particularly when the couple planned to remain in New Jersey indefinitely. In light of the estate tax repeal, however, that plan could generate an unnecessary \$400,000+ estate tax liability that could be eliminated by deferring the gift until the surviving spouse’s death (assuming the surviving spouse lives past 2017) or by having the surviving spouse make the gift after the first spouse dies (since New Jersey does not have a gift tax).

There are other, less common, situations

that may require changes to existing estate plans. An individual whose present estate plan ties the amount of a bequest to New Jersey’s estate tax exemption could see dramatic and unwanted results if his or her plan is not changed. For example, assume Jane has a \$5 million estate, and that her will leaves “the maximum amount that can pass free of state estate tax” to her children and the excess amount to her spouse.

If Jane dies December 31, 2016, Jane’s children receive \$675,000 and Jane’s spouse receives \$4,325,000.

If Jane dies in 2017 – even one day later – Jane’s children receive \$2 million and Jane’s spouse receives \$3 million.

If Jane dies in 2018, Jane’s spouse is disinherited, and all assets will pass to Jane’s children.

### What other legislative changes accompanied the estate tax repeal?

The legislation to repeal New Jersey’s estate tax also included the following changes: (i) a \$0.23 per gallon gas tax increase; (ii) a sales and use tax decrease from 7% to 6.875% on January 1, 2017 and to 6.625% on January 1, 2018; (iii) an increase in the earned income tax credit and the pension and retirement income tax exclusion; and (iv) a new income tax exemption for veterans.

### What should I do now?

While New Jersey’s estate tax repeal will produce meaningful tax savings for many families, in most cases it will be necessary to update existing

plans to maximize tax savings, achieve greater simplicity and cost savings for one’s heirs, or both. Thus, if you are interested in achieving tax savings and/or reducing administrative complexity and cost, you should contact us to explore possible changes to your estate plan.

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