2022 NJSBA Annual Meeting

Estate Planning 101

Moderator/Speaker:
Dana Bennett, Esq.
Bennett & Wyatt, LLC, Red Bank

Speakers:
Kevin R. Centurrino, Esq.
Berkowitz Lichtenstein Kuritsky Giasullo & Gross, LLC, Roseland
Tara S. Sinha, Esq.
Witman Stadtmauer, P.A., Florham Park

NJ ESTATE PLANNING 101

Dana A. Bennett, Esq.
Bennett & Wyatt LLC
(732) 268-7520
dbennett@bennettwyatt.com

Kevin R. Centurrino, Esq.
Berkowitz, Lichtstein, Kuritsky, Giasullo & Gross, LLC
(973) 530-2489
kcenturrino@blkgg.com

Tara S. Sinha, Esq.
Witman Stadtmauer, P.A.
(973) 822-0220
tsinha@wsmesq.com

TABLE OF CONTENTS

Chapter 5 Page

Chapter 6 Page

Chapter 1
Estate Planning Overview

A. INTRODUCTION

Estate planning is an area of law which applies to everyone, regardless of the size of their estate. In order to be able to properly plan your client's estate, you should have an intimate understanding of the client's assets, family dynamics, and last wishes, knowledge of federal and state tax laws, and familiarity with the rules of asset protection.

B. DEFINITION AND GOALS

Estate planning may be defined as a series of steps you take now to protect yourself and your assets during your lifetime and to protect and provide for your loved ones in the manner that you wish after you are gone, using every legal strategy available to minimize your taxes and protect your assets.

Estate planning involves much more that simply drafting wills in order to distribute assets. Some of the many other goals that may also be involved in the planning process include to:
- provide for a client's potential incapacity or the incapacity of a loved one
- appoint guardians for minor children
- provide for children from a prior marriage
- minimize the impact of transfer taxes
- efficiently transfer closely held business interests
- protect assets in the event of a future creditor claim
- preserve a child's inheritance
- protect against spendthrifts
- disinherit a family member
- make bequests to specific individuals
- achieve the client's charitable wishes

The list above is not all-inclusive. Each client's situation is unique. Understanding the needs of your particular client will help you tailor the best plan to reach the client's goal.

C. BASIC ESTATE PLANNING DOCUMENTS

While each client's estate plan will vary, there are certain documents that should be drafted in order to satisfy the basic estate planning needs of every client. All clients should have a will, a durable power of attorney to deal with their property, and an advanced directive for health care to assist with their medical decisions. Depending on the client's circumstances and wishes, a revocable living trust may also be warranted.

The client's will is generally the cornerstone of the estate plan. In the will, the client dictates the individuals and organizations that should receive the client's assets upon the client's death, the manner of distribution to such beneficiaries, and the persons or entities who will be charged with carrying out the client's intentions. In the event the client has minor children, the will also serves to nominate the individuals the client would like to have appointed as guardians of those children if the client were to die before the children reach adulthood.

The durable power of attorney is a document which permits the client to appoint an agent to take care of the client's financial decisions during the client's lifetime. The fact that it is durable allows it to continue to apply even when the client is incapacitated. The powers granted under the durable power of attorney end at the client's death.

The advanced medical directive generally consists of a proxy directive and a living will. The health care proxy directive is a document wherein the client appoints an agent to make medical decisions on behalf of the client during the client's incapacity. A living will (which may be incorporated into the health care proxy directive or may stand alone) allows the client to express his or her own wishes as to medical treatment when the client is terminally ill and unable to communicate.

A revocable living trust is appropriate for clients who have assets in more than one state, who are concerned about the cost and time delays of probate, who are concerned with the privacy that is lost when a will is offered for probate and becomes a public document, and/or who wish to ensure ease of administering their assets in the event they become incapacitated. The revocable living trust typically contains the dispositive provisions that would otherwise be found in the client's will and works together with the will to ensure proper administration of the client's estate.

Depending on the size and the nature of the client's estate, additional planning and documents may be warranted. For example, if the client has large life insurance policies which are taxable in the estate, an irrevocable trust may be desirable to hold those policies and keep them out of the estate. An irrevocable trust may also be necessary to accomplish goals of lifetime gifting to minor beneficiaries. If the client has a closely held business interest, buy sell agreements and other special planning for beneficiaries may be necessary. If a client is concerned with asset protection, transfers to a limited liability company or the creation of an asset protection trust may be appropriate. If the client is charitably inclined, several options exist to make charitable transfers, both during the client's lifetime and upon the client's death. These are just some of the many nuances in planning that can arise based on the total picture presented by your client.

D. OTHER PLANNING CONSIDERATIONS

The client's asset portfolio, including the way assets are titled, should be thoroughly reviewed. Depending on how title to an asset is taken, the client may or may not be able to provide for distribution of the asset through the client's will. In addition, retirement assets and life insurance policies should be reviewed to ensure that the beneficiary designations and contingent beneficiary designations are current and in accordance with the client's wishes, particularly in light of significant familial changes, such as death or divorce. Both of these assets may require additional planning outside of the basic planning being discussed in this outline. The operating agreements of closely held businesses should be reviewed to see if there are any restrictions tied to their transfer.

In addition to understanding the client's assets, the client's family structure should be explored to see whether any special planning is warranted. A client may have a disabled family member, a family member who lacks fiscal responsibility, minor children, children in occupations that are ripe for lawsuits or in less than stable marriages, or other situations may exist which would warrant more extensive planning.

E. FORMS OF PROPERTY OWNERSHIP

As discussed above, the way that title is taken to a particular asset will govern whether it passes by operation of law upon an individual's death or whether it will be distributed under his or her will or revocable living trust, if any, or the laws of intestacy. Assets that are held in fee simple or as a tenancy-in-common will pass under a client's will or revocable living trust or, if none, under the intestacy laws of the state. On the other hand, assets that are held in joint tenancy with right of survivorship or in a tenancy by the entirety will pass by operation of law to the surviving owner, even if the will or revocable living trust provides for an alternate disposition.

F. PROBATE VS. NONPROBATE PROPERTY

Probate assets are assets that are distributed under the terms of a client's will. The will is a public document and must be filed with the Surrogate's Court in the county where the decedent was domiciled. An executor must be appointed to handle the probate assets and the Surrogate must issue Letters Testamentary in order for the executor to handle those assets. If there is no will, a petition for administration of those assets must be filed with the Surrogate's Court and an administrator will be appointed to work with those assets under authority of Letters of Administration.

There are certain assets, however, that do not pass under the terms of a will. As discussed above, assets that are held in the form of joint tenancy or tenancy by the entirety pass by operation of law to the surviving owner. Similarly, assets that have "payable on death" or "transfer on death" designations pass by operation of law to the designated individual. Life insurance and retirement assets are governed by contract and pass to the designated beneficiary. Finally, assets that are held in a revocable living trust pass according to the terms of the trust agreement and avoid the probate process entirely.

G. EVERYONE HAS AN ESTATE PLAN – THE RULES OF INTESTACY

Everyone has an estate plan. If an individual dies without a will, the laws of intestacy in the state of the individual's domicile will determine who is entitled to receive the individual's assets. In New Jersey, these rules are found at N.J.S.A. 3B:5-1 *et. seq*. Unfortunately, the laws of intestacy often do not mirror how a client would wish for his or her assets to be distributed upon death and should never be relied upon in lieu of a well-thought out estate plan.

The New Jersey rules of intestate succession are provided here to help you help your client understand what would happen in the event that they do not proactively plan. Most people incorrectly assume that everything would automatically pass to their surviving spouse or to their children. This is only the case in certain circumstances.

> ***3B:5-3. Intestate share of decedent's surviving spouse or domestic partner.***
>
> *The intestate share of the surviving spouse or domestic partner is:*
>
> *a. The entire intestate estate if:*
>
> *(1) No descendant or parent of the decedent survives the decedent; or*
>
> *(2) All of the decedent's surviving descendants are also descendants of the surviving spouse or domestic partner and there is no other descendant of the surviving spouse or domestic partner who survives the decedent;*
>
> *b. The first 25% of the intestate estate, but not less than $50,000.00 nor more than $200,000.00, plus three-fourths of any balance of the intestate estate, if no descendant of the decedent survives the decedent, but a parent of the decedent survives the decedent;*

c. The first 25% of the intestate estate, but not less than $50,000.00 nor more than $200,000.00, plus one-half of the balance of the intestate estate:

(1) If all of the decedent's surviving descendants are also descendants of the surviving spouse or domestic partner and the surviving spouse or domestic partner has one or more surviving descendants who are not descendants of the decedent; or

(2) If one or more of the decedent's surviving descendants is not a descendant of the surviving spouse or domestic partner.

3B:5-4. Intestate shares of heirs other than surviving spouse or domestic partner.

3B:5-4. Intestate shares of heirs other than surviving spouse or domestic partner.

Any part of the intestate estate not passing to the decedent's surviving spouse or domestic partner under N.J.S.3B:5-3, or the entire intestate estate if there is no surviving spouse or domestic partner, passes in the following order to the individuals designated below who survive the decedent:

a. To the decedent's descendants by representation;

b. If there are no surviving descendants, to the decedent's parents equally if both survive, or to the surviving parent, except as provided in section 4 of P.L.2009, c.43 (C.3B:5-14.1);

c. If there are no surviving descendants or parent, to the descendants of the decedent's parents or either of them by representation;

d. If there is no surviving descendant, parent or descendant of a parent, but the decedent is survived by one or more grandparents, half of the estate passes to the decedent's paternal grandparents equally if both survive, or to the surviving paternal grandparent, or to the descendants of the decedent's paternal grandparents or either of them if both are deceased, the descendants taking by representation; and the other half passes to the decedent's maternal relatives in the same manner; but if there is no surviving grandparent, or descendant of a grandparent on either the paternal or the maternal side, the *entire estate passes to the decedent's relatives on the other side in the same manner as the half;*

e. If there is no surviving descendant, parent, descendant of a parent, or grandparent, but the decedent is survived by one or more descendants of grandparents, the descendants take equally if they are all of the same degree of kinship to the decedent, but if of unequal degree those of more remote degree take by representation;

f. If there are no surviving descendants of grandparents, then the decedent's step-children or their descendants by representation.

H. GATHERING INFORMATION

As discussed previously, a full understanding of a client's assets and family structure is critical to creating a proper estate plan. The process for gathering client information varies widely among practitioners. Some attorneys like to gather background information at the initial in-person meeting with the client and then form a plan from there. Other attorneys prefer to have the client complete a questionnaire form prior to the meeting which can then be reviewed ahead of time. One advantage of this latter approach is that it allows clients more time to remember all of their assets and to obtain more accurate detail as to the value and title of those assets. By collecting the information in advance, the initial meeting with the client can be more productive as it allows the attorney to have time beforehand to consider planning strategies that may be appropriate or follow up questions that may be warranted for the client's particular situation.

I. CLIENT ENGAGEMENT

Once the client has decided to move forward, it is essential that you have the client sign an engagement letter which sets forth the terms under which you will be engaged. Fees should be expressly discussed with the client at the meeting and also in the engagement letter so that there is no misunderstanding and later conflict. You may wish to charge hourly for the work or on a flat fee basis.

J. ETHICAL CONSIDERATIONS

Ethical conflicts abound in this area of the law. There are inherent conflicts that exist when planning for a married couple[1] and one must be careful to outline these conflicts at the outset of taking on representation. Similarly, conflicts can arise when representing more than one generation of the same family or even partners in a business arrangement. In each instance, the attorney must be careful to identify the conflict to the client and to either obtain a waiver, in which the client agrees to allow the attorney to represent the other party with whom a conflict may exist, or decline representation. The waiver should be in the form of a writing signed by the client.

K. THE PLANNING PROCESS

While this varies from practitioner to practitioner, the planning process generally involves the following steps:

1. *Gathering information either before or at the initial client meeting*.

2. *Initial meeting*.

    The initial meeting is a time for the attorney to understand the client's wishes and also a time for the attorney to educate the client as to the various laws and planning considerations that can affect the client's estate. If the client is ready to engage at this meeting, they should sign the engagement letter and you can move forward with designing their estate plan (either at this meeting or a follow up meeting).

    The attorney may wish to prepare a letter, short memo, or email to the client after the design meeting in which the attorney outlines the planning that was discussed. This can avoid any confusion in the future as to why particular recommendations were made and also serves to confirm that the client understands and agrees to the planning before any documents are actually drafted.

3. *Drafting of documents*.

    It is the authors' suggestion that the attorney should send the clients drafts of the documents in order to give them a chance to review before signing, together with a

[1] See, for example, A v. B v. Hill Wallack, 726 A.2d 924 (N.J. 1999) , where a law firm that was jointly representing a husband and wife in the planning of their estates was entitled to disclose to the wife the existence of husband's child born out of wedlock. The law firm had obtained this information from the child's mother when she retained the firm in a paternity action against the father.

summary, so that the clients have a chance to raise any questions or concerns prior to signing.

4. *Execution of documents*.

After receiving all comments and changes, documents should be prepared in final form for execution. Each document should be reviewed to ensure that it satisfies any requirements with respect to witnessing or notarization (including self-proving affidavits) in accordance with the terms of state law.

5. *Processing of the executed documents*.

Depending on the practitioner, the original documents may be retained by the attorney or returned to the client.

If the original will is retained by the attorney, the attorney should provide a conformed copy of the will to the client. A conformed copy is a copy of the will where the signatures of the testator/testatrix, witnesses and notary are typed in to the document as opposed to having a photocopy of those signatures. The reason for having a conformed copy is to avoid the possibility that a photocopy of the signed will may be misconstrued as the original. At the top of the document, the attorney should type in "Copy. Original retained by [name of law office]".

If the attorney's practice is to return the originals to the client, the attorney should make copies for the attorney's file (including a conformed copy of the will) and should have the client sign an acknowledgment itemizing each original document returned to the client. This should be retained by the attorney and simply serves as a record as to the original location of the documents. It may also be a place where the attorney notes where the client plans to keep the original will in case the attorney is called to help locate it when the client dies.

The client should be advised to review the documents and any non-probate beneficiary designations at least annually and more frequently if there are any major life changes (e.g., marriage, death, birth of a child, death of a fiduciary, relocation, etc.) to make sure that the planning in the documents is updated to reflect the client's present situation.

6. *Follow up*.

After the documents have been signed, the attorney should schedule time to follow up to make sure that beneficiary designations have been tied down and that any assets that needed to be retitled have been properly titled.

Thereafter, depending on how your office process is structured, you may wish to do an annual review of the client's plan or a review once every few years to ensure that the plan is current in light of changing tax laws.

Chapter 2
Drafting Considerations - Wills and Trusts

A. WILL DRAFTING

1. Overview

The will is often the most important document in a client's basic estate plan. It is based on statutory law which authorizes its validity. The statute provides guidance as well as default provisions that are meant to apply in the event the will does not address a particular provision. Through the will, it is possible for the attorney to create a plan that truly embodies a client's wishes for how assets are to be controlled and distributed after the client's death.

Clients often come in to see their attorney with a sense of what it is that they wish to have happen once they are gone. The attorney should always listen to the client's wishes and yet determine whether there are more practical solutions that can be offered or other considerations that the client needs to be made aware of as part of the planning process. As a counselor who is looking at the whole picture, the attorney is in the best position to advise the client about tax, asset protection, long term care, the need for insurance, and other issues that the client may not have considered when initially formulating the plan.

2. Statutory Requirements

In New Jersey, the laws regarding the valid execution and witnessing of a will are set forth in N.J.S.A. 3B:3-1 through 3B:3-4.

Any individual who is at least eighteen (18) years of age and who is of sound mind may make a will in New Jersey.[2] The statute requires that, in order for the will to be valid, the will must be:

> *a. in writing;*
>
> *b. signed by the testator or in the testator's name by some other individual in the testator's conscious presence and at the testator's direction; and*
>
> *c. signed by at least two individuals, each of whom signed within a reasonable time after each witnessed either the signing of the will as described in paragraph (2) above or the testator's acknowledgment of that signature or acknowledgment of the will.*[3]

---

[2] N.J.S.A. 3B:3-1.
[3] N.J.S.A. 3B:3-2.

Any individual generally competent to be a witness may act as a witness to a will.[4]

> PRACTICE TIP: Although the statute provides that the will is not invalidated if signed by an interested witness,[5] the best practice is always to have the will signed by two disinterested witnesses.

The statute recognizes the validity of a holographic will as a "writing intended as a will" even if it does not comply with the requirements set forth above and whether or not it is witnessed as long as the signature and material portions of the document are in the testator's handwriting.[6]

In addition to the proper execution of the will, for wills drafted after September 1, 1978, the statute provides for the will to be self-proving if a self-proving affidavit is attached to the will.[7] If a will is self-proving, there is no need for the attesting witnesses to appear in the Surrogate's Court to prove the will when it is offered for probate.

> PRACTICE TIP: Given the difficulty of locating witnesses years after a will is executed and the possibility that the witness may not even be alive when the will is offered for probate, a self-proving affidavit should be attached to every New Jersey will.

The self-proving affidavit may be executed either at the same time that the will is executed or at a later time.[8]

3. Identifying the Testator/Testatrix and Family Members

At the outset of the will, it is important to identify the full legal name of the testator or testatrix (and any other names under which he or she may be known), the county of residence, and the fact that this will (if a prior will was executed) supersedes any prior will.

It is also helpful to state whether the testator/testatrix is married, the name of the spouse (if any), and the names of any children.

Finally, if any family member who would otherwise be a natural taker under the will is intentionally not provided for in the will, it is better to state this upfront so as to preclude any future will contest by the individual with claims of being mistakenly omitted from the will.

---

[4] N.J.S.A. 3B:3-7
[5] N.J.S.A. 3B:3-8.
[6] Id.
[7] N.J.S.A. 3B:3-4
[8] N.J.S.A. 3B:3-5

4. Fiduciary Appointments

There are certain fiduciary appointments that the client should make in the will. These include an executor of the will, guardians of any minor children, and trustees of any trusts established under the will. Clients should inform the individuals that they name to these positions before executing their documents in order to ensure that their estate planning is not later disrupted by someone who is surprised by the responsibility and does not wish to take on the role to which he or she has been nominated.

The executor of the client's will is tasked with probating the client's will with the appropriate Surrogate's Court, gathering the client's assets and distributing them as provided for in the will, and making sure that the client's final tax returns (income, estate and gift) are filed and that the taxes are paid. The client should consider naming an alternate or successor executor in the event the one that is named is unable to serve.

If the client has minor children, a guardian should be nominated in the will. As discussed above, a successor guardian should also be named in the will in case the individual initially nominated is unable to serve. The guardian will be responsible for taking care of each minor child until the child reaches the age of 18 years.

If the client intends for assets to be distributed upon his or her death into one or more trusts for beneficiaries, the client should name an initial trustee and at least one successor trustee for each such trust. While it may be that the client wishes to have the same individuals or organizations serve as trustee for all of the trusts created under the client's will, the length of each trust and the beneficiaries involved may dictate a different result. Trusts will typically be established in a will if the client wants to control how and when beneficiaries receive the money (as in the case of minor children) or if the client wants to take advantage of certain estate tax exemptions (as discussed in later in this outline) for distributions to a spouse or to a trust where a grandchild may be a beneficiary.

The trustee of a trust is the person who is charged with the day to day administration of the trust. The trustee must ensure that the trust funds are prudently invested and that distributions are timely made in accordance with the trust document.

The trustee may be an interested person (e.g., a beneficiary of the trust) as long as the trust provides for mandatory distributions of income and principal or if the trust incorporates an ascertainable standard (defined to mean limiting distributions to those necessary for the beneficiary's health, education, maintenance, or support) for discretionary distributions to such individual. These safeguards are necessary in order to keep the value of the trust assets out of the estate of the trustee and also in order to prevent the trustee's creditors from reaching assets of the trust. If the trustee is not an interested trustee, trust distributions may be completely within the trustee's discretion. Accordingly, the selection of trustee may partially depend on how much control the client wants to give to the trustee.

Clients often ask whether the person they name as guardian can also be named as trustee of any trusts established for their children. There is no right or wrong answer to this question. Some people believe that there should be a system of checks and balances and so prefer to name someone other than the guardian to be the trustee in charge of handling the child's funds. Others believe that the same person is best suited for both roles. Ideally, the client should name as trustee an individual or corporate fiduciary who the client feels understands and can best uphold the client's financial philosophy as it would apply to investment of trust funds and any discretionary distributions for the beneficiary of the trust.

The additional factors that must be considered when drafting a will are discussed below in Section C of this Chapter 2 as they are the same factors that apply whether drafting wills or revocable living trusts.

B. UNDERSTANDING AND DRAFTING TRUSTS

A trust is essentially a vehicle for controlling how assets are held and distributed. There are two main categories of trusts that can be established during a client's lifetime (inter vivos trusts): revocable trusts and irrevocable trusts. Both of these may have a place in the client's estate plan. A trust that is established in a client's will is formed only upon the client's death and is known as a testamentary trust.

1. Revocable Trusts

Revocable trusts are typically used to manage the client's assets during his or her lifetime and are generally established for the client's benefit. This type of trust is often utilized to achieving a client's basic estate planning goals.

As discussed in Chapter 1, a revocable living trust should be considered for clients in the following situations:

- They have assets in more than one state;
- They wish to avoid the cost and time delays associated with probate;
- They are concerned about the privacy that is lost when a will is offered for probate and becomes a public document; and/or
- They wish to ensure ease of administering their assets in the event they become incapacitated.

Other reasons that have been offered for planning with revocable trusts in New Jersey include: 1) revocable trusts may be amended without the same formalities required for a will, and 2) assets in a revocable trust appear to be exempt from the tax waiver requirements that are otherwise imposed before certain assets can be distributed from an estate.

It should be noted at the outset that a revocable living trust does not offer any asset protection to the client and does not reduce the client's estate taxes in any way that cannot be accomplished through a will. Clients often have a misconception or have been ill-advised about these two points, and it is best to clarify them from the beginning of the planning process.

Revocable living trusts are generally established with the client serving as the trustor or grantor (the trust maker) of the trust, the beneficiary of the trust, and also the initial trustee of the trust. There is no separate tax identification number that is needed for the revocable living trust and no separate tax return is filed for a revocable living trust while the client is alive and the trust is revocable (all income and expense of a revocable trust is reported on the client's personal income tax return[9]). The trust is generally drafted to provide that it can be amended or revoked at any time.

A revocable living trust can be analogized to an invisible box into which the client places his or her assets. The box is "invisible" because, during the client's lifetime (while the trust is revocable), nobody can tell that the assets are held inside the box unless they check the title to the asset. Once the client dies, however, the trust becomes irrevocable and the box becomes solid, at which point an outsider cannot see which assets are held in the box and how the assets are to be distributed.

An asset is transferred into a trust by changing the way title is held to the asset (e.g., instead of the title to a bank account being held as "Judy Brown", it would be retitled to "Judy Brown, Trustee of the Judy Brown Revocable Living Trust dated May 15, 2017"). Note that the ownership of certain assets, such as life insurance contracts and retirement plan assets, cannot be transferred into the revocable living trust. In addition, certain other assets, such as shares in a co-operative apartment, are subject to the rules of the governing authority, in this case the co-op board, which determines whether or not the asset can be placed in the revocable living trust. Any asset that is transferred into the trust passes free of probate upon the client's death. However, the asset is still included in the client's taxable estate for estate tax purposes.

During the client's lifetime, as long as the client is trustee, the client manages the assets in the trust and the assets are available to the client for his or her use. If the client becomes

[9] See IRC Section 676 and Treas. Reg. Section 1.671-4.

incapacitated or no longer wishes to serve as trustee, the individual or corporate institution designated as successor trustee steps up to continue managing the assets in the trust on the client's behalf. When the client passes away, assets in the trust are distributed in the manner that the client has set forth in the trust agreement. The considerations as to how assets are to be distributed upon the client's death are similar to those when planning with a will, and are discussed below in Section C of this Chapter 2.

When a revocable living trust is part of an estate plan, the dispositive provisions will generally appear in the trust agreement and not the will. The client will still need a will in order to handle the probate of any assets that were not placed in the trust during the client's lifetime. In addition, if the client has minor children, the will is needed to nominate the guardians for those minor children. Finally, the will is needed if the client wishes to exercise a power of appointment which by its terms requires that it be exercised in the client's will. When a will is working in conjunction with a revocable living trust, the will basically serves to pour over any assets that are outside the trust into the trust at the time of the client's death. This is appropriately called a "pour over will".

The trust agreement for the revocable living trust serves as the roadmap for the trust once it is established. In the trust agreement, the client should designate the individuals or institutions that are to serve as successor trustees of the revocable living trust upon the client's incapacity and upon the client's death. If assets remaining in the client's trust are to be distributed in further trust, the client will need to designate the trustees and successor trustees of those continuing trusts. In addition, the client must set forth how assets are to be distributed upon the client's death, who will be the beneficiaries, the manner in which distributions will be made from any resulting trusts, who will be the remainder beneficiaries of those trusts, and who will be the contingent beneficiaries. The trust agreement should set forth the rights, responsibilities, and powers of the trustees, the manner in which trustees may resign or in which vacancies in the position of trustee are to be filled, and how death taxes will be paid upon the client's death.

2. Irrevocable Trusts

Irrevocable trusts are often used to move assets out of the client's estate. An irrevocable trust is simply that, irrevocable. The terms of the trust, including the beneficiaries and the manner of distributions to the beneficiaries, are theoretically fixed from the time the trust is executed. Significantly, however, it may be possible to modify some irrevocable trusts under the provisions of the New Jersey Uniform Trust Code discussed in more detail below in Subsection B 3 of this Chapter 2.

An irrevocable trust to which a completed gift has been made is a standalone entity. It may have its own tax identification number and file its own tax returns. Alternatively, the irrevocable trust can be structured as a "grantor trust", which simply means that the net income of the trust is taxable to the grantor/trustor on his or her personal income tax return. Specific provisions must be drafted into the trust agreement in order for the trust to be treated as a grantor trust.

When a grantor transfers assets to an irrevocable trust during his or her lifetime, the grantor is generally making a gift and will need to allocate a portion of his or her lifetime gift tax exemption to the gift if the gift is for an amount greater than that which can annually be given to the beneficiaries of the trust by such grantor (the annual gift tax exclusion amount, $16,000 in 2022). If the grantor wants to qualify some or all of the transfer to the trust as a present gift so as to qualify for the annual exclusion amount (and not a gift of a future interest), the Trustee must issue a notice (referred to as a "Crummey notice" or "Crummey letter") to the trust beneficiaries. This letter should state that a gift has been made to the trust and that the beneficiaries have the right to withdraw their proportionate share of the gift by written notice to the Trustee within a specified period.

A few of the reasons a client may consider establishing an irrevocable trust as part of his or her estate plan include:

- to transfer certain assets such as life insurance out of the client's estate now in order to reduce the potential estate tax liability the estate will incur on the face value of the policy when the client dies;
- to shield certain assets from potential future creditors by removing them to a trust over which neither the grantor nor the beneficiary has discretionary control; and
- to make current gifts to minor or adult beneficiaries under terms and conditions to be determined by the grantor and in a manner that will prevent minor beneficiaries from gaining legal access to the gifts upon reaching the age of majority.

Irrevocable trusts tend to be used in many scenarios that are beyond the scope of basic planning for a client. Accordingly, they are discussed further in Chapter 6 of this outline.

3. New Jersey Uniform Trust Code

Attorneys who draft revocable or irrevocable trusts should familiarize themselves with the New Jersey Uniform Trust Code (N.J.S.A. 3B:31-1 et.seq.). The Uniform Trust Code was adopted into law on January 19, 2016 and became effective on July 17, 2016. Among other things, it contains provisions regarding (i) the creation, validity, modification and termination of trusts, (ii) creditor's claims, spendthrift and discretionary trusts, (iii) revocable trusts, (iv) duties and powers of trustees and (v) liability of trustees and the rights of persons dealing with the trustee.

C. ADDITIONAL DRAFTING CONSIDERATIONS IN WILLS AND REVOCABLE LIVING TRUSTS

Irrespective of whether a client's plan is centered on a will or a revocable living trust, there are certain planning considerations that are the same for each dispositive instrument. These issues are discussed in more detail here.

1. Drafting for cash legacies and specific bequests

The client may wish to make bequests of cash or specific property to certain individuals or organizations upon the client's death. If the client is married, determine whether the bequest is to be made when the client dies or only if the client is the last spouse to die.

A specific bequest is a gift of a specific interest in the client's property. If the subject of the bequest is not cash, the attorney should clearly identify which property is intended to be transferred, the name and relationship of the beneficiary, whether the gift is being made subject to any liens or encumbrances, and whether death taxes are to be apportioned to the recipient of the gift or whether such taxes will paid from the residue of the client's estate.

If the beneficiary of the bequest is an individual, the full name of the beneficiary should be provided, together with the relationship to the client. If the beneficiary is a class of individuals, the class should be clearly identified (e.g. "all of my then living grandchildren").

If the beneficiary is a charitable organization, the full corporate name of the organization should be provided, together with its tax identification number (if available) and address. Finally, if the beneficiary is an existing trust, the full name of the trust, together with the date of the trust, should be provided.

Due to the fact that it may take some time for the executor of the will or the trustee of the revocable living trust to distribute the specific gift to the named beneficiary, language should be included in the instrument directing whether the expenses of such bequest in the interim period will be borne by the estate or the beneficiary.

The instrument should also identify what happens in the event that the specific property that was gifted is not a part of the estate at the time of client's death.

2. Provisions for Tangible Personal Property

The dispositive instrument should clearly state who is to receive the client's tangible personal property. This is property that the client owns for which there is no title but which may hold sentimental or other value. The term tangible personal property generally includes household items, jewelry, furniture, clothing, etc.

In many instances, there will be certain articles of tangible personal property which the client wishes to distribute to specific individuals (e.g. "my gold Rolex watch to my son, JOHN SMITH"). While it is possible to provide for gifts of such specific items in the will or revocable living trust, items of tangible personal property are often newly acquired or gifted away during the client's lifetime, and it would be cumbersome to have to update the instrument each time there was such a change. The attorney may wish to include a provision in the dispositive instrument granting the client the right to dispose of items of tangible personal property by a written statement that is in the handwriting of the client or signed by him or her and which reasonably identifies the property intended for disposition and the devisees or beneficiaries, with the last such writing to control.[10] The client should be counseled to clearly identify the property in the writing, even attaching a photograph if it helps to clarify which item is being gifted. The writing should be signed and dated and kept with the original of the client's will and revocable living trust. There should also be default language in the instrument as to who is to receive items of tangible personal property in the event no such writing is prepared.

Finally, similar to what happens in the case of a specific gift of any other property, the instrument should include language providing for who is responsible for the cost of moving, storing, packaging, insuring and shipping the tangible personal property.

3. Distribution of the Residue

The residuary estate, or residue, typically consists of all of the property that remains in the probate estate or trust after giving effect to specific bequests or devises, distributions of tangible personal property, and after payment of debts, administration expenses and funeral expenses. The attorney should always draft to account for distribution of the residue, even if it seems that most of the assets have been accounted for by the other sections of the will, in order to avoid application of the rules of intestacy to assets that are not otherwise specifically gifted.

The residue may be distributed either outright or in trust to one or more individuals or organizations. If the distribution is to be made in unequal shares, the portion or percentage to

[10] N.J.S.A. 3B:3-11.

each beneficiary should be clearly stated. The attorney should ask the client how the gift should be handled in the event that a beneficiary predeceases the client (e.g., the gift lapses, it passes to descendants of the beneficiary *per stirpes*, it passes to the other named beneficiaries pro rata, etc.).

4. Basic planning scenarios

The more common situations that the attorney is likely to encounter and the types of planning that should be considered with respect to planning for the residue of the client's trust or estate are discussed below.

a. Single client no children.

If the client is single and has no children, the client's dispositive instrument should specifically state which individuals or organizations will receive the residue of the client's estate. If more than one beneficiary is named, the client should identify the portion of the residue that will pass to each beneficiary. Because it is difficult to predict what the value of the client's estate will be at the time the client dies, and unless the client is planning to split the residue equally among the named beneficiaries, it is generally better to use percentages to define the share allocated to a particular beneficiary.

If the client wants to leave certain assets or a certain percentage of assets to a named individual, the attorney should discuss how those assets are to pass if the beneficiary predeceases the client (e.g., the gift lapses, the gift is to be distributed to the beneficiary's descendants, etc.).

Finally, the client should decide whether each beneficiary is to receive his or her bequest or devise outright or in trust. If the gift is to be made in trust, the mechanics of the trust (e.g. trustees, beneficiaries, timing and nature of distributions, etc.) must be drafted into the dispositive instrument. These mechanics are further discussed in paragraphs (b) and (c), below, as they relate to planning with trusts.

> PRACTICE TIP: When planning for a client who is single and has no children, the attorney should be particularly mindful of the New Jersey Transfer Inheritance Tax rules. The Transfer Inheritance Tax is discussed in more detail later in this outline, but it essentially applies to bequests and devises made to anyone other than a spouse, parents, or descendants or charities. The rate of tax varies depending on the relationship of the transferee to the decedent.

b. Single client with children.

If a client is not married but has children, he or she will most likely want the residue of his or her estate to pass to his or her children. Typical planning in this situation involves having the residue divide equally and be distributed to the client's descendants, *per stirpes*. In this context, per stirpes means that the client's children will receive equal shares of the residue, but if one child has predeceased the client, that deceased child's share will be distributed equally to that child's children (or later descendants, with each later descendant taking his or her pro rata share of the share of his or her deceased ancestor) if any, otherwise it will be distributed pro rata to the client's other living children.

The attorney should discuss whether the client wishes to follow this pattern of distribution or whether the client has another idea of how assets are to be distributed among his or her descendants. An example of a situation where a client may not want assets to be distributed equally is if the client's major asset is a closely held business interest and only one child works in the business. In such instance, the client may want to have that child inherit the business and then provide for the other child(ren) through other means, including purchases of life insurance, that are not included in the dispositive instrument.

If the client's children are minors, or if the client wants to ensure that the assets are protected and not distributed to the children until certain specific ages or intervals, the dispositive instrument should provide for each child to receive his or her share of the residue in trust. If the children are not close in age, the client may wish to have the assets first be distributed into a common or pot trust for the benefit of all of the children until the youngest child reaches a certain age. The trustee of the common trust could be given discretion to "sprinkle" income and principal of the trust among the trust beneficiaries in order to ensure that a younger child's trust funds are not depleted for expenses such as education and/or medical care that the client might have paid for an older child before passing away. When the youngest child reaches the specified age, the common trust would then split into separate trusts for the client's children and would be administered as provided in the trust agreement going forward. Alternatively, the client may wish to have a separate trust for each child established immediately upon the client's death. This is a question that should be asked of the client in designing the estate plan.

The client will need to name a trustee for each trust (either the same or separate trustees can be named) and will need to decide when the trustee should make distributions of income and principal to each child from the child's separate trust.

The client may wish to have the trust drafted to allow the trustee to distribute to the child at any time such amount as is needed for the child's health, education, maintenance and support. This ascertainable standard allows the basic necessities to be provided for, even if assets are to remain in trust for a much longer period. The next step is to decide whether the assets of the trust should be distributed outright to the child at one or more ages or stages of life, and the amount or percentage that should be distributed at each point.

As with everything else, clients have different ideas as to when their children will be fiscally responsible and should receive the assets of their respective trusts outright. The attorney should take this opportunity to explain to the client the benefits and detriments of having assets stay in trust for the child. While assets remain in the trust, a trustee selected by the client can continue to manage the trust assets. In addition, depending on how the trust is drafted, the child's assets may receive greater asset protection from any future creditor claims as long as they are held in the trust and not required to be distributed to the child.[11] Finally, the assets are less likely to be depleted while held in the trust.

One potential deterrent to having assets held in trust is that separate annual income tax returns will need to be filed for the trust while it is in existence. In addition, a trustee will have to remain responsible for the trust assets for the duration of the trust which, in the event the client wishes to have a lifetime trust, could impose quite a burden. Where the client is considering naming a family member or friend as the trustee of the trust, the client may not wish to impose on that individual the responsibility of overseeing the trust for such a long period of time. If this is the case and yet the client does want to have the assets stay in a lifetime or dynasty trust, the client may be well advised to appoint a corporate or institutional trustee.

There are countless choices as to how assets of the child's trust should be distributed. Some of the more common planning techniques include:

1) Providing for the child to receive a lump sum at a certain age;
2) Providing for the child to receive the assets in two or three tranches (e.g. 1/3 of the trust assets when the child reaches the age of 25 years, 1/2 of the balance when the child reached the age of 30 years, and all of the trust assets distributed out when the child reached the age 35 years); and

[11] See Tannen v. Tannen, 416 N.J. Super. 248, 262 (App. Div. 2010), aff'd, 208 N.J. 409 (2011), where the Supreme Court of New Jersey affirmed the Appellate Division's holding that, for purposes of determining alimony, it was not appropriate to impute income to a wife based on her beneficial interest in an irrevocable trust created and funded by her parents.

3) Providing for the child to receive an annual unitrust amount.

As divorce rates and creditor claims have increased over time, more clients are opting to keep assets in trust for a longer period, even up to the child's lifetime, in order to protect the child's inheritance from a potential future ex-spouse or creditor of the child. In these longer term or lifetime trusts, the trustee may be authorized to make discretionary distributions to cover any needs that child may have (assuming a third party trustee) until the required distribution or during the child's lifetime If there is no required mandatory distribution of the trust assets, the trust can provide greater asset protection to the child against potential creditor and predator (i.e., ex-spouse) claims.

c. Married Client (In General)

If the client is married, he or she will typically want the entire residue to be distributed first to his or her surviving spouse. Depending on the size of the estate and whether the client wants his or her spouse to receive the assets outright or in trust, there are several tax considerations that must be factored into how this is drafted in the dispositive instrument.

The client may simply provide for his or her surviving spouse to receive everything outright upon the client's death. If the dispositive instrument is drafted this way, it may work for clients with a modest estate where no tax planning is required. However, if the client has a taxable estate, or if the surviving spouse is not a United States citizen, the attorney should counsel the client as to the tax issues that can be involved with leaving everything to the surviving spouse outright. These tax issues are discussed in Chapter 3 of this outline in greater detail. Summarily, however, one of the consequences of leaving everything outright to a surviving spouse who is a U.S. citizen is that an unlimited marital deduction applies to reduce the estate tax to zero for the deceased spouse, thereby removing the need and ability to apply the deceased spouse's estate tax exemption (and thereby losing such spouse's estate tax exemption against the overall estate of the married couple, at least for state estate tax purposes, if there is an applicable state estate tax). If the client's surviving spouse is not a U.S. citizen, assets above the estate tax exemption amount will be taxed immediately unless left in a qualifying trust for the benefit of the surviving spouse. The relevant estate tax exemption is the federal estate tax exemption (for 22022, $12,060,000 per person). Under current law, the New Jersey estate tax is repealed as of January 1, 2018; however, the permanency of the repeal of the New Jersey estate tax remains uncertain, thus making planning for married individuals even more complex.

In order to ensure that the estate tax exemptions that would otherwise be available to the estate of the deceased spouse are not lost by way of the unlimited marital deduction, the dispositive instrument could be drafted to provide for at least one trust (known as a credit shelter trust, exemption trust, or bypass trust) to be established upon the client's death to which these exemptions can be allocated. The income tax issues related to such a trust should be considered as part of the estate plan discussion.

If the client desires to have assets pass in trust for the lifetime of the client's surviving spouse and then have any remaining assets pass to other beneficiaries (e.g., the client's children), the trust must be drafted as a qualified terminable interest property trust (a "QTIP" trust, discussed more fully in Chapter 3) if the client wants the trust assets to qualify for the unlimited marital deduction. This requires that all income of the trust must be payable at least annually to the surviving spouse and that he or she be the only beneficiary of the trust during his or her lifetime. An affirmative QTIP election must be made on the decedent's estate tax return in order for the trust assets to receive the unlimited marital deduction.[12]

The manner in which the credit shelter trust and the QTIP trust (if any) are funded is important to the overall estate plan for a married couple. Some of the more common planning techniques for residuary interests that are to pass to a surviving spouse are discussed below:

(1) Disclaimer Planning:

If the client wants to preserve maximum flexibility in determining how much to fund into the credit shelter trust, the dispositive instrument can be drafted to give all of the deceased spouse's assets to the surviving spouse, either outright or in trust, and permit the surviving spouse to disclaim any portion of those assets into the credit shelter trust. This provides the most flexibility as the surviving spouse can determine at the time of the first spouse's death whether to transfer any amount at all into the credit shelter trust. This option may be more appropriate where the total estate of the married couple is not much greater than the former New Jersey estate tax exemption amount of $2,000,000, in the event the tax is ever reinstated, or if the clients anticipate that they might move to a state which still has an applicable estate or inheritance tax.

Some attorneys do not like to rely on disclaimer planning to fund the credit shelter trust as there is a possibility that the surviving spouse may fail to make a timely qualified disclaimer (within 9 months of date of death for federal purposes, although there is no time deadline for New Jersey). Even if a timely disclaimer can otherwise be made, if the

[12] IRC Section 2056(b)(7).

surviving spouse has accepted any part of the deceased spouse's assets, those assets cannot be disclaimed. Finally, the surviving spouse loses the power to appoint any disclaimed assets. A power of appointment is a valuable tool that the client may want to retain for the surviving spouse so that he or she has ultimate say in who among a class of beneficiaries defined by the decedent, such as children of the deceased spouse, inherits the remaining trust assets. Notwithstanding the above, with the uncertainty of the future of the New Jersey estate tax, or whether a client might later move to a state that still has an applicable estate or inheritance tax, disclaimer planning is quickly becoming more widely accepted.

(2) Clayton Election

Planning with a Clayton election stems from a case called Estate of Arthur M. Clayton, Jr. v Commissioner, 976 F2d 1486 (CA 5, 1992). This type of planning provides for all assets to initially be held in a QTIP-able trust (a trust for which a QTIP election can be made). The income interest of the surviving spouse is contingent upon an election by the fiduciary to treat the marital trust property as QTIP property. To the extent the election is made, that property remains in the QTIP trust, while the non-elected portion of the QTIP trust property is generally distributed to the surviving spouse or the decedent's descendants, either outright or in further trust, such as a credit shelter trust.

One advantage of planning with a Clayton election over a standard disclaimer will is that the fiduciary has 15 months from the decedent's date of death to make the election. In addition, because the assets are held in a QTIP style trust from the outset, there is no worry that the surviving spouse may accept assets and then lose the power to disclaim, as disclaimer is not necessary. Finally, given that a fiduciary other than the surviving spouse is making the election in a Clayton type situation, some of the emotional element that may otherwise cloud traditional disclaimer planning is removed.

(3) Mandatory Funding

If the client wants to ensure that no state or federal taxes are due upon the first to die of the client and the client's spouse, the will or revocable living trust should be written in a manner that allows the credit shelter trust to be funded with assets equal to the federal estate tax exemption amount (if there is no New Jersey estate tax) or the state estate tax exemption amount (if there is a New Jersey estate tax).

d. Planning for a married client with no children:

When planning for a married client who has no children, many of the same considerations with respect to residuary distributions will apply at the time of the surviving spouse's death as discussed previously for a single person with no children. In the case of the married client, however, he or she will need to determine how and to whom assets remaining in the credit shelter trust (if any) and the QTIP trust (if any) should pass. Assuming that there was no power of appointment over trust assets that was granted to and exercised by the surviving spouse, any assets that remain in a particular trust will be distributed to the beneficiaries designated by the client as the remainder beneficiaries of that respective trust. The remainder beneficiaries may be individuals or organizations, and assets may be distributed outright or in further trust to each beneficiary. The client will need to identify the portion of the residue of each trust that is to pass to each beneficiary and the terms of the distribution to such beneficiary.

e. <u>Planning for a married client with children</u>:

When planning for a married client with children, the first step will be to determine whether the children are from the current marriage or from a prior marriage. If the children are from a prior marriage and the client wants to ensure that the children are taken care from the assets remaining after the death of the client's spouse, the distribution of any assets to the surviving spouse should be made in a QTIP trust. The client may also want the children to receive something immediately at the time of his or her death, in which case the children, together with the surviving spouse or without the surviving spouse as the case may be, can be made beneficiaries of the credit shelter trust. If the client wishes for the children to receive all of the credit shelter amount outright and free of trust (as may be the case if the children are already adults), a credit shelter trust may not be warranted and the assets in an amount equal to the exemption amount can be gifted directly to the children in the will or revocable living trust. If the client wishes to gift more than the exemption amount to the children at the time of the client's death, tax issues should be considered. The purchase of life insurance on the client's life naming the children as beneficiaries may be one way to accomplish the client's goal of providing the children with assets greater than the exemption amount at the time of the client's death, especially if the life insurance is held in a trust for the benefit of the children only.

If the children belong to both the client and the current spouse, then the planning tends to follow the more traditional methods outlined above. Typically, the client will want the surviving spouse to inherit everything for his or her lifetime (as discussed in paragraph (c), above), and then the children will take equal shares of any assets remaining in the credit shelter trust and/or QTIP trust either outright or in trust. As discussed above, the client may wish to provide for the children to be current discretionary beneficiaries of the credit shelter trust together with the surviving spouse. The client can provide in the dispositive instrument that distributions to the surviving spouse are to take priority over distributions to other beneficiaries, that distributions to one class of beneficiaries (e.g., children) take priority over distributions to another class (e.g., grandchildren), or that there should be no priority among beneficiaries for purposes of distributions from the trust.

If any assets are to be distributed to a client's children in trust, the client will want to decide whether a common trust is necessary for the children or whether each child should receive his or her share in separate trust immediately. The client's dispositive instrument will also need to designate the trustee and successor trustee(s) of each trust and the manner in which assets of the child's trust are to be distributed. The instrument should include language that discusses what happens if a child dies before his or her trust has been fully distributed out.

5. *Planning for contingent beneficiaries – the "Wipe Out" clause*

The contingency clause (or wipe out clause as it is sometimes known) dictates who should inherit any part of the client's undistributed probate or trust estate in the event that all of the named beneficiaries in the instrument die before the assets are fully distributed. The client may wish to name specific family members, friends, and/or charitable organizations that should inherit in such instance, specifying the portion that should be distributed to each such beneficiary. If no one is designated, the instrument should at least provide for the assets to pass to the client's heirs at law in order to avoid having the assets escheat to the state.

6. Tax Apportionment Clause

The tax apportionment clause of a dispositive instrument specifies who will be responsible for the death taxes (e.g., federal and state estate taxes and inheritance tax) that are due on the assets of the estate. The New Jersey Tax Apportionment Statute[13] provides that the estate tax will be apportioned to the estates of decedents domiciled in New Jersey as set forth in the will or other nontestamentary instrument (e.g., a trust, IRA, 401K , etc.).[14] Accordingly, if the client wishes to specify that all or only certain beneficiaries bear responsibility for the death taxes that stem from their share of the client's estate, or if the client wants to require that all taxes be paid from the residuary estate, this should be specifically provided for in the dispositive instrument.

There are three ways that the dispositive instrument can provide for apportionment:

---

[13] N.J.S.A. 3B:24-1 *et. seq.*
[14] N.J.S.A. 3B:24-2.

a. Full apportionment – full apportionment means that each beneficiary of a taxable asset bears its proportionate share of the tax liability.
b. No apportionment – no apportionment indicates that the tax liability will not be apportioned amongst the beneficiaries and instead will be paid by the residuary estate.
c. Partial apportionment – partial apportionment refers to shifting the tax that would otherwise be allocated to beneficiaries of certain assets to another source (such as the residuary estate).

It should be noted that special rules apply if a portion of the residuary estate is intended to qualify for the estate tax marital deduction. In this case, the dispositive instrument should direct that taxes be paid from other assets in order to avoid reducing the available marital deduction by the amount of the tax liability.

If the will or nontestamentary instrument is silent with regard to tax apportionment, or if the decedent died intestate, the statute provides as the default rule that federal and state estate taxes will generally be apportioned "among the fiduciary and each of the transferees interested in the gross tax estate whether residents or non residents of the State, in accordance with the rules of apportionment stated in this chapter, and the transferees shall each contribute to the tax the amounts apportioned against them."[15] In the absence of direction to the contrary, the tax to be apportioned to each of the transferees will bear "the same ratio to the total tax as the ratio which each of the transferees' property included in the gross estate tax bears to the total property entering into the net estate for purposes of that tax, and the balance of the tax shall be apportioned to the fiduciary."[16] Generally, this means that death taxes generated by non-probate assets will be paid by the transferees of such property and taxes generated by probate property will be paid out of the residuary estate. In addition, transfers subject to the New Jersey inheritance taxes can be recovered from the transferee of the property.

7. Simultaneous Death Clause

"Simultaneous death" refers to a situation where two or more individuals who were intended to be beneficiaries of each other's estate under a will, trust, or other governing instrument die at the same time. In New Jersey, the concept of simultaneous death applies if a beneficiary fails to survive a decedent by 120 hours.[17] Once that time period has elapsed, the beneficiary will be considered to be the survivor of the two if still alive. This 120 hour period for

[15] N.J.S.A. 3B:24-2.
[16] N.J.S.A. 3B:24-4(a).
[17] N.J.S.A. 3B:3-32(a).

determining simultaneous death may be increased or decreased if so provided in the governing instrument.[18]

Where a simultaneous death has occurred, statutory law provides guidance as to how assets are to be distributed. [19]Generally, where the title to property depends upon priority of death, the property of each person is disposed of as if he had survived.[20] If there are two co-owners that have a right of survivorship or who are joint tenants or tenants by the entirety and who die simultaneously, one-half of the property passes as if one had survived and one-half passes as if the other had survived.[21] In addition, if there are more than two co-owners or joint tenants that own property and that die simultaneously, property passes in proportion that one bears to the whole number of co-owners or joint tenants, respectively.[22] These default rules can be overridden if an alternate arrangement is expressly set forth in the governing instrument.

Simultaneous death becomes an important concept when dealing with a married couple where one spouse (the "rich spouse") has substantially greater assets than the other spouse (the "poor spouse"). In this scenario, if the rich spouse survives the poor spouse, the poor spouse may not have enough assets to fund a credit shelter trust and the rich spouse would end up paying more in taxes. Conversely, if the rich spouse predeceases the poor spouse, there may be sufficient assets to take advantage of the estate tax exemptions for both spouses. With the introduction of portability and the repeal of the New Jersey estate tax, the order of passing between spouses may take on less significance. Accordingly, in a rich spouse/poor spouse situation where: 1) the poor spouse does not have enough assets to fund a credit shelter trust, and 2) each is intending to leave everything to the other, the dispositive instruments of the married couple should specify that, in the event of simultaneous death, the poor spouse will be deemed to be the surviving spouse.

8. Fiduciary Powers

The New Jersey Fiduciary Powers Act[23] provides a fairly comprehensive listing of the powers that an Executor or Trustee may take with respect to assets within its control. Some practitioners prefer to simply cite to this statute or to state law in providing for the powers granted to the fiduciary in the will or revocable living trust. A better practice, however, is to state these powers again in the document so that the fiduciary (and any third party that is working with the fiduciary) is not put in the position of having to locate a statute to see if the

[18] N.J.S.A. 3B:3-32(d).
[19] See N.J.S.A. 3B:3-32 and N.J.S.A. 3B:6-1 *et. seq.*
[20] N.J.S.A 3B:6-2.
[21] See N.J.S.A. 3B:3-32(b) and N.J.S.A. 3B:6-4.
[22] See N.J.S.A. 3B:3-32(c) and N.J.S.A. 3B:6-4.

fiduciary has the power to act in a certain matter. In addition, specifically enumerating the powers in the document allows expansion of the authority to act with respect to certain interests (e.g., closely held business interests) that are not covered by the statute.

9. Bond Waiver Provisions

Unless specifically provided in the dispositive instrument, a bond is required for certain fiduciaries.[24] Most wills and revocable living trusts relieve the fiduciaries named in the document from this bond requirement.

[23] N.J.S.A. 3B:14-23 *et. seq.*
[24] See N.J.S.A. 3B:15-1 *et. seq.*

Chapter 3
Overview of Federal Estate and Gift Taxation

Clients often overlook the fact that there may be tax consequences that attach to the gifts they wish to make either during their lifetimes (inter vivos gifts) or at the time of their death. Both federal and state taxes must be considered when crafting the estate plan. The key federal transfer taxes that should be considered in developing the estate plan are discussed here in greater detail.

A. UNIFIED SYSTEM OF TAXATION

The federal transfer tax system consists of three separate transfer taxes: (1) the federal estate tax; (2) the federal gift tax; and (3) the federal generation-skipping transfer ("GST") tax. The federal estate tax applies to transfers at death; the federal gift tax applies to inter vivos or lifetime transfers; and the federal GST tax applies to transfers to individuals more than one generation below that of the transferor (e.g., grandchildren and lower generations) that would otherwise escape taxation under the other transfer tax rules.

The transfer tax system imposed by the federal government is presently a unified tax system. What this means is that a single tax liability is imposed on the cumulative transfers by a decedent during his or her lifetime and at death.

B. AMERICAN TAXPAYER RELIEF ACT OF 2012 & TAX CUTS AND JOBS ACT OF 2017

On January 1, 2013, President Obama signed into law the American Taxpayer Relief Act of 2012 ("ATRA"), which set the per person estate, gift, and GST tax exemption amount at $5,000,000, as adjusted for inflation going forward. [25]

On December 22, 2017, President Trump signed into law the Tax Cuts and Jobs Act (the "Act"), which in part increased the per person estate, gift, and GST tax exemption amount to $10,000,000, as adjusted for inflation going forward. For 2022, the exemption is $12,060,000. This means that in 2022, the first $12,060,000 of an individual's estate can be transferred, either during lifetime or upon death, free of federal estate, gift, or GST tax. Married couples have an aggregate exemption of twice this amount, or $24,120,000 in 2022. Absent further action by Congress, under the Act the increased exemption will sunset on January 1, 2026, reverting the exemption amount to $5,000,000 (as adjusted for inflation).

Both ATRA and the Act also provide for a maximum tax rate of 40% for any transfers in excess of the estate, gift, or GST exemption amount in the year of transfer.

---

[25] Reference Proposed Obama Budget.

C. ESTATE TAX

The federal estate tax is imposed on the taxable estate of every decedent who is a citizen or resident of the United States at the time of death.[26] Noncitizen, nonresidents are only subject to tax on their taxable estate which is situated in the United States at the time of death, and are only entitled to a much reduced estate tax exemption amount.[27]

In order to calculate the federal estate tax, it is necessary to first determine the gross estate of the decedent.[28] This amount is then reduced by certain permissible deductions in order to determine the decedent's taxable estate.

1. *Calculation of the Gross Estate*

A decedent's gross estate generally includes the value of all of the property owned by the decedent partially or outright at the time of death. This amount is increased by the following:

a. the value of a surviving spouse's dower or curtsy interest in a property;[29]
b. the value of certain property the decedent transferred during the three years immediately preceding the date of death;[30]
c. the value of certain property transferred by the decedent before death in which the decedent retained a life estate, or retained certain powers;[31]
d. the value of certain property in which the recipient's possession or enjoyment is contingent upon surviving the decedent;[32]
e. the value of certain property in which the decedent retained a reversionary interest valued in excess of 5% of the value of the property;[33]
f. the value of certain revocable transfers made by the decedent before death;[34]
g. the value of certain annuities;[35]

[26] See IRC Section 2001(a).
[27] See IRC Section 2101.
[28] Defined at IRC Section 2031 and Section 2033.
[29] See IRC Section 2034.
[30] See IRC Section 2035.
[31] See IRC Section 2036.
[32] See IRC Section 2037(a)(1).
[33] See IRC Section 2037(a)(2).
[34] See IRC Section 2038.
[35] See IRC Section 2039.

h. the value of certain jointly owned property, such as assets passing by operation of law (e.g. payable on death designation accounts) or by survivorship (e.g. joint tenants with right of survivorship), with special rules for assets owned jointly by spouses.;[36]

i. the value of certain powers of appointment;[37] and

j. the amount of proceeds of life insurance policies owned by the decedent or over which the decedent retained incidents of ownership.[38]

2. Deductions from the Gross Estate

Certain deductions are permitted against the gross estate in calculating the value of the decedent's taxable estate. These deductions include, but are not limited to:

a. Deductions for funeral expenses, administration expenses, and claims against the estate;[39]
b. A charitable deduction for certain charitable contributions;[40]
c. A marital deduction for certain property left to a surviving U.S. citizen spouse;[41] and

d. The state death tax deduction (generally any estate, inheritance, legacy, or succession taxes paid as the result of the decedent's death to any state or the District of Columbia).

For married taxpayers, the marital deduction is usually the most important of the deductions available against the gross estate as it can serve to eliminate any estate tax that may otherwise be due upon the death of the first spouse. This unlimited marital deduction is only available, however, if the surviving spouse is a U.S. citizen. If the surviving spouse is not a U.S. citizen (even if the surviving spouse is a U.S. resident), the unlimited marital deduction is only available if the decedent's assets pass into a trust which can be treated as a Qualified Domestic Trust ("QDOT"). [42] The QDOT is a special type of trust which defers income tax on the death of the first spouse but which requires that distributions of trust principal (other than certain distributions for hardship) be taxed when made at the decedent's estate tax rate. Accordingly, a QDOT generally serves to defer estate tax only until such time as distributions of principal are made to the surviving spouse.

[36] See IRC Section 2040.
[37] See IRC Section 2041.
[38] See IRC Section 2042.
[39] See IRC Section 2053.
[40] See IRC Section 2055.
[41] See IRC Section 2056.
[42] See IRC Section 2056 (d).

3. Tentative Tax

The tentative estate tax is determined by adding back to the taxable estate the amount of adjusted taxable gifts made by the decedent on or after 1976. This amount is then reduced by the gift tax that would have been paid on those adjusted taxable gifts, as such gift tax is determined using the rates in effect at the decedent's date of death.

Under IRC Section 2001(c), the tentative tax rates for 2013 and beyond are as follows:

If the amount with respect to which the tentative tax is to be computed is:	**The tentative tax is:**
Not over $10,000	18% of such amount
Over $10,000 but not over $20,000	$1,800, plus 20% of the excess of such amount over $10,000
Over $20,000 but not over $40,000	$3,800, plus 22% of the excess of such amount over $20,000
Over $40,000 but not over $60,000	$8,200, plus 24% of the excess of such amount over $40,000
Over $60,000 but not over $80,000	$13,000, plus 26% of the excess of such amount over $60,000
Over $80,000 but not over $100,000	$18,200, plus 28% of the excess of such amount over $80,000
Over $100,000 but not over $150,000	$23,800, plus 30% of the excess of such amount over $100,000
Over $150,000 but not over $250,000	$38,800, plus 32% of the excess of such amount over $150,000
Over $250,000 but not over $500,000	$70,800, plus 34% of the excess of such amount over $250,000
Over $500,000	$155,800, plus 35% of the excess such amount over $500,000

Over $500,000 but not over $750,000	$155,800, plus 37% of the excess such amount over $500,000
Over $750,000 but not over $1,000,000	$248,300, plus 39% of the excess such amount over $750,000
Over $1,000,000	$345,800, plus 40% of the excess such amount over $1,000,000

4. *Credits*

After determining the tentative tax, it is necessary to consider which credits are available to reduce the tentative tax. The most important of the credits is generally the applicable credit amount. The applicable credit amount is equal to the tax on the applicable exclusion amount and is available to offset the aggregate of the taxable estate and the taxable lifetime gifts. In 2022, the applicable credit amount is derived from the $12,060,000 applicable exclusion amount and is equal to $4,769,800.

D. GIFT TAX

The federal gift tax applies to the irrevocable lifetime transfer of assets and is due on April 15th of the calendar year following the year of the gift. In certain cases, such as where actual tangible property or money is transferred, it is clear that a gift has been made. However, even if the property is retained but the use of property or the right to receive income from property is transferred (assuming there is no expectation of receiving something of at least equal value in return), a gift is made. In addition, if an asset is sold for less than its fair market value or a loan is made without adequate interest, a gift may be made.[43]

1. *General Rule*

The general rule is that any transfer of property for no consideration or for less than adequate consideration is a taxable gift. However, there are several exceptions to this rule, including:

a. Gifts, excluding gifts of future interests, that are less than or equal to the annual exclusion for the calendar year.
b. Tuition or medical expenses which are paid directly to an educational or medical institution for someone else,
c. Gifts to a spouse (assuming the spouse is a U.S. citizen),[44]
d. Gifts to a political organization for its use, and

[43] See IRS Publication 950, Introduction to Estate and Gift Taxes.
[44] Reserved.

e. Gifts to qualified charities.

2. *Annual exclusion gifts*
Each and every individual may make a gift to any one or more person up to the annual gift tax exclusion amount without incurring gift tax liability. The annual exclusion amount is $16,000 for 2022. A separate annual exclusion applies to each person to whom the transferor makes a gift. Accordingly, a single transferor can make annual gifts of $16,000 or less to as many people as he or she would like without incurring a gift tax liability.

For years prior to 2022, the annual exclusion amount was as follows:

Gift Tax Annual Exclusion	
Year(s)	**Annual Exclusion**
1998 – 2001	$10,000
2002 – 2005	$11,000
2006 – 2008	$12,000
2009-2012	$13,000
2013-2017	$14,000
2018-2021	$15,000

3. Lifetime Gift Tax Exclusion
In addition to the annual exclusion gifts discussed above, taxpayers are entitled to use their lifetime gift tax exclusion towards inter vivos gifts that exceed the annual exclusion amount. As discussed above, the Act provides that the lifetime gift tax exclusion for 2018 and future years is equal to $10,000,000, indexed for inflation ($12,060,000 for 2022). As with the estate tax exemption, absent further action by Congress, on January 1, 2026 the amount will revert to $5,000,000, indexed for inflation After you determine which of your gifts are taxable, you figure the amount of gift tax on the total taxable gifts and apply your available applicable credit amount for the year. It should be noted that the taxpayer's available applicable credit amount in any year is the total applicable credit amount available for the year ($4,769,800 in 2022) reduced by that amount allocated to prior lifetime transfers. The applicable credit amount applied to lifetime gifts will reduce the amount of the applicable credit amount available to offset testamentary transfers.

4. *Gift Splitting*
A married couple may choose to split gifts that are made during the year. If the election to split gifts is made for a given year, however, all of the gifts during that year must be split.

E. GENERATION SKIPPING TRANSFER TAX

The Generation Skipping Transfer Tax (“GST” tax) is imposed on lifetime or testamentary transfers made to skip persons. A “skip person” is a person who belongs to a generation that is two or more generations below the generation of the donor. For example, a grandchild will generally be a skip person to a grandparent.

The GST tax is calculated on the value of the property transferred to a skip person, after reducing such amount by any GST exemption allocated to the transfer at the maximum gift and estate tax rates. Each individual has a GST exemption equal to the basic exclusion amount, as indexed for inflation, for the year involved. The GST exemption for 2022 is $12,060,000 per person.

GSTs have three forms: direct skip, taxable distribution, and taxable termination.

A *direct skip* is a lifetime or testamentary transfer that is:

Subject to the gift or estate tax,

Of an interest in property, and

Made to a skip person.

A *taxable distribution* is any distribution from a trust to a skip person which is not a direct skip or a taxable termination.

A *taxable termination* is the end of a trust's interest in property where the property interest will be transferred to a skip person.

Allocation of GST exemption to a transfer to a skip person will cause that transfer to pass free of GST Tax to the skip person.

F. PORTABILITY

The concept of “portability” of the federal estate tax exemption was first introduced into law by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, and was applicable for estates of decedents who died in the 2011 and 2012 tax years. In 2013, ATRA made the concept of portability permanent. The Act does not make any changes to portability.

Portability permits the unused estate tax exemption amount of the first spouse to die to be passed to the surviving spouse for later use by the surviving spouse (either for gifts made during the surviving spouse's lifetime or at death) under certain circumstances.

> Example: If A, the first spouse passes away in 2022 (when the applicable exemption amount is $12,060,000) with $3,000,000 of assets (which utilizes a portion of A's unused exemption), A's deceased spousal unused exclusion ("DSUE") of $9,060,000 can be inherited by B, the surviving spouse. B would then have a total of $21,120,000 of gift and estate tax exemption going forward, subject to certain limitations.

Portability is not automatically available. In order to qualify for portability, the executor must make an affirmative election on a timely filed United States Estate and Generation Skipping Transfer Tax Return, IRS Form 706, including extensions.[45] Currently, this rule applies even if the deceased spouse's estate was under the federal estate tax exemption and would not otherwise be required to file IRS Form 706.

Portability requires that only the last deceased spouse's unused exemption amount is available to the surviving spouse. For example, if husband dies and wife gets remarried only to have husband two also predecease her, she would be limited to the DSUE left to her by husband two.

The idea behind the introduction of portability was to preserve the federal estate tax exemption for couples who otherwise did not properly plan their estate to take advantage of the estate tax exemption of the first spouse to die. By way of background, where one spouse leaves all of his or her assets to the other spouse outright or in certain trusts, no estate tax is imposed at the time of death of the first spouse due to the unlimited marital deduction (assuming the surviving spouse is a United States citizen). As a result, however, the federal estate tax exemption that was available to the first spouse is typically lost. The way to plan around this is to have the deceased spouse's assets, up to the estate tax exemption amount, fund a trust for the benefit of the surviving spouse (or for the surviving spouse and the descendants of the deceased spouse). The deceased spouse's estate tax exemption is then allocated to this trust, which is commonly called the credit shelter trust, exemption trust, or bypass trust. Portability allows clients whose estate plans do not include plans for credit shelter trusts to still benefit from their deceased spouse's unused federal estate tax exemption.

While portability does provide some relief, it is subject to important limitations. The major deterrents to relying on portability as a planning device is that there is no portability for the decedent's federal GST tax exemption. In addition, in cases where the New Jersey estate tax is applicable, New Jersey does not recognize portability for state estate tax exemption purposes

[45] See IRC Section 2010(c)(5)(A).

(discussed further below). Accordingly, relying on portability as an estate plan does not work if the client plans to take advantage of the state estate tax exemption upon the death of the first spouse or if the client wishes to make gifts (i.e., indirect skips) which could result in the imposition of a GST tax at a later date.

G. PLANNING TO PRESERVE THE MARITAL DEDUCTION

The unlimited marital deduction for federal estate tax purposes is available for assets that are included in the decedent's gross estate and that are transferred to his or her surviving spouse either outright or in a qualifying trust.[46] This deduction is only available if the surviving spouse is a U.S. citizen. If the surviving spouse is not a U.S. citizen, the estate tax may be deferred if assets are held for the benefit of the surviving spouse in a trust that qualifies as a Qualified Domestic Trust, the rules for which are set forth in IRC Section 2056A.

A client may wish to have assets pass in trust for the spouse's benefit (as opposed to outright) for a number of reasons. For one, the client may believe that the surviving spouse does not have the financial wherewithal to manage the assets and would rather have them managed by an independent trustee. Second, the client may wish to provide greater asset protection to the surviving spouse with respect to the inherited assets. Third, the client may wish to be certain that any assets that the surviving spouse does not consume during his or her lifetime pass to certain beneficiaries, such as children from a prior marriage, upon the death of the surviving spouse. If assets were to pass outright to a surviving spouse, the surviving spouse could dispose of those assets as he or she desired (e.g., pass them to a new spouse or children that are not the decedent's children) without being subject to any limitations.

When a client wishes to have assets pass into a trust for the benefit of his or her surviving spouse, the client must designate who will receive the remainder interest upon the death of his or her spouse. However, the marital deduction is not available for any interest that passes to the surviving spouse and that is treated as a "terminable interest".[47] A terminable interest is defined as an interest that terminates or fails "on the lapse of time, on the occurrence of an event or contingency, or upon the failure of an event or contingency to occur."[48] Typically, a testamentary trust where the surviving spouse is the lifetime beneficiary and then the decedent's descendants are contingent beneficiaries is treated as a terminable interest. There are two major exceptions to this rule:

1. A General Power of Appointment Trust ("GPOA Trust")– this is a testamentary trust with life income to the surviving spouse, with the surviving spouse having a general power of

[46] See Section IRC Section 2056(a).
[47] See Section IRC Section 2056(b).
[48] IRC Section 2056(b)(1).

appointment over the remainder interest to others, or to him or herself, or to his (her) estate; and

2. A Qualified Terminable Interest Property Trust ("QTIP Trust") – a testamentary trust consisting of property which passes from the decedent, in which the surviving spouse is entitled to all of the income for life from the property (trust) payable annually or at more frequent intervals, and where no person, other than the surviving spouse, has a power to appoint any part of the property during the surviving spouse's lifetime to any person or persons other than the surviving spouse.

The term "property" includes an interest in property, including a specific portion of any property. An election must be made for the property, or any portion thereof, to be treated as a QTIP trust on the decedent's federal estate tax return (Form 706).

If the client is seeking to ensure that assets that remain in the trust upon the death of his or spouse go to specific remainder beneficiaries (e.g., the client's children), as is often the case, the General Power of Appointment Trust will not work. The QTIP trust is more commonly used in estate plans created today to permit this type of planning.

It should be noted that while both the GPOA Trust and the QTIP Trust will qualify for the estate tax unlimited marital deduction, any assets remaining in those trusts upon the death of the surviving spouse will be included in the surviving spouse's taxable estate.

H. BASIS CONSISTENCY RULES

The basis of property received from a decedent's estate must be consistent with the value reported on the estate tax return, Form 706. To ensure compliance with this consistency requirement, an executor must file a Form 8971 with the IRS. This form is filed separately from Form 706. The executor must furnish Schedule A of the form to the beneficiaries of property received from the estate. The value reported on Form 8971 is then used by the estate beneficiary as his or her initial basis in the property. Form 8971 must be filed the earlier of (i) thirty (30) days after the deadline for filing Form 706, (including extensions) or (ii) thirty (30) days after the return is filed.

The filing of Form 8971 is required where the personal representative of an estate is required to file Form 706 under 6018(a) and 6018(b). Those executors who are not otherwise required to file Form 706 but choose to file it solely for the purpose of electing portability or making an allocation or election with respect to generation skipping transfer tax, would not be required to file Form 8971.

Chapter 4
New Jersey Estate, Gift and Inheritance Taxes

A. OVERVIEW

Up until 2018, the New Jersey transfer tax system consisted of estate tax and inheritance tax. New Jersey does not have a state gift tax.

Prior to 2017, the New Jersey estate tax applied to the estates of all residents of New Jersey whose gross estate plus adjusted taxable gifts as determined in accordance with the provisions of the Internal Revenue Code in effect on December 31, 2001 exceeded $675,000. In late 2016, the law was revised to increase the New Jersey estate tax exemption to $2,000,000 for individuals dying in 2017. The 2016 law repealed the New Jersey estate tax for individuals dying in 2018 or later. It remains to be seen whether New Jersey will reinstate the estate tax.

The New Jersey inheritance tax applies to testamentary transfers of property to individuals other than ancestors, descendants, and the surviving spouse or civil union partner of the decedent, as well as transfers to most charities. In addition, transfers made within the three years prior to the transferor's death are brought back in to the estate for purposes of determining the inheritance tax. The first $500 of gifts or bequests to each transferee is not subject to the inheritance tax. The rate of tax is determined based on the relationship of the transferee to the transferor.

B. HISTORY OF THE NEW JERSEY ESTATE TAX

It is still important to understand the history of the New Jersey estate tax. While New Jersey does not currently have an estate tax, this could change again in the future.

The New Jersey estate tax was first enacted in 1934 as a "sponge" tax or "pick up tax" in order to collect the amount allowable by the Internal Revenue Code as a state death tax credit for state inheritance, estate, succession, or legacy taxes.

For tax years starting in 2002, the federal estate tax exemption amount increased and the provision for state death tax credits was eliminated. Since New Jersey did not want to lose tax revenue, New Jersey revised its laws on July 1, 2002, so that it could continue to collect estate taxes on estates $675,000 or more, effectively "decoupling" from the federal law. The revised New Jersey law applied retroactively to estates of taxpayers who died after December 31, 2001, and was calculated by treating taxpayers as though they had died on December 31, 2001. The New Jersey estate tax rate ranged from 4.8% to 16%. That law remained in effect until 2017 when legislation was passed in late 2016 centered on New Jersey's transportation trust fund.

Pursuant to the 2016 legislation, the estate tax for decedents dying in 2017 is determined in accordance with the provisions of the Internal Revenue Code in effect on January 1, 2017. The estate tax is calculated using a progressive rate schedule with rates ranging from 0% to 16%. Estates must use an estate tax calculator located on the Division of Taxation's website to determine the tentative tax. The calculator performs the circular calculation created by application of the New Jersey portion of the federal state death tax deduction to the taxable estate, in accordance with Section 2058 of the Internal Revenue Code.

The following Subparagraphs 1-3 primarily pertain to New Jersey decedents dying before 2018

1. State Estate Tax Exemption

As discussed earlier in this outline, the federal rules of portability do not apply to the New Jersey estate tax exemption. Accordingly, if a married decedent's will provides that all of his or her assets are to pass to his or her surviving spouse either outright or in a qualifying trust, and he or she died in 2017 or earlier, the unlimited marital deduction will apply (assuming the surviving spouse is a U.S. citizen) and no tax will be due upon the death of the first spouse. Unfortunately, however, this planning would cause the estate of the first deceased spouse to lose the ability to take advantage of the New Jersey estate tax exemption that would otherwise have been available to the estate of the first spouse to die. The surviving spouse would still be entitled to his or her own estate tax exemption upon death, assuming the surviving spouse has not remarried by that time and left all assets to his or her new spouse.

EXAMPLE: H and W have a combined estate of $3 million, with each owning $1.5 million in assets. H has an "I love you" will that says, upon his death, all of his assets are to pass outright to W. H dies in 2016. The marital deduction applies and no tax is due upon H's death. Upon W's death in 2017, her estate would be able to take advantage of her state estate tax exemption ($2,000,000 in 2017). The remaining assets ($1,000,000 in this example) would be subject to state estate tax.

With proper planning, the estate tax exemption of both spouses may be preserved even where a married individual would like all of his or her assets to pass for the benefit of his or her surviving spouse. As discussed earlier in this outline, the client's will or revocable living trust must require that a credit shelter trust (also known as the exemption trust, or the bypass trust) be established upon the client's death. How much is funded into this trust will depend on how the client's will is drafted.

Irrespective of the planning method chosen, the beneficiary of the credit shelter trust may be anyone the client wishes to designate, although it is usually either the surviving spouse alone or the surviving spouse together with the decedent's descendants. The decedent's estate tax exemption can now be allocated to the assets in the credit shelter trust as those assets are not treated as passing to the surviving spouse.

2. State QTIP Only

New Jersey, like the federal estate tax law, permits a marital deduction for assets that pass to the surviving spouse outright or in a qualifying trust. If assets will be passing to the surviving spouse in a qualifying trust, New Jersey requires taxpayers to be consistent with their federal and state QTIP elections. Accordingly, if a federal estate tax return is filed and QTIP treatment is elected, New Jersey requires that the same election be made for state purposes. If a federal return is filed and no QTIP election is made, then no QTIP election is permitted for state purposes.

Given the large discrepancy between the federal and state estate tax exemptions, there are certain situations where no federal estate tax return is necessary and yet a QTIP election needs to be made in order to obtain a marital deduction for state estate tax purposes. In this limited circumstance, New Jersey permits a state only QTIP election.[49] For example, if a married decedent dies with assets valued at $4 million, no federal estate tax return is required to be filed. However, a New Jersey estate tax return would need to be filed in order to make the QTIP election for the amount over the state estate tax exemption amount.

3. *The Portability Trap*

As mentioned above, New Jersey requires taxpayers to be consistent with respect to whether or not a QTIP election is made for federal and state estate tax purposes. Generally, no federal estate tax return is required to be filed for a decedent whose estate is less than the federal estate tax exemption amount. However, if a surviving spouse wishes to benefit from the portability rules for federal estate tax purposes, a federal estate tax return (Form 706) must be filed to elect portability. If the decedent's estate is less than the federal exemption amount, no QTIP election needs to be made on that Form 706 and the only reason for filing is to preserve the portability of the decedent's unused exclusion amount. This places New Jersey taxpayers in a quandary, as the filing of the federal estate tax return in order to make the portability election but with no QTIP election precludes the possibility of making a state only QTIP election.

New Jersey attorney Robert Borteck, in recognition of the dilemma faced by New Jersey residents that wanted the benefit of portability but also wanted to ensure they would be able to benefit from the state only QTIP election, wrote a letter to the Division of Taxation where he raised these issues. On January 31, 2011, Fred M. Wagner, on behalf of the Division of Taxation (the "Division"), replied to Mr. Borteck's request for clarification on the issue of portability by restating the Division's position that a separate New Jersey QTIP election is only permitted if a federal estate tax return is not filed. If a federal estate tax return is filed, regardless of the reason for filing, any QTIP election or failure to make a QTIP election for federal purposes will apply for New Jersey purposes as well. As of the writing of this outline, there has been no change in the Division's position.

It should be noted that New Jersey does not have a portability election with respect to the New Jersey exemption amount that may remain unused by a deceased spouse. Accordingly, if the client's will is not crafted in a manner that will allow his or her state exemption amount to be used, it will be lost.

NOTE: In September 2016, the IRS issued Revenue Procedure 2016-49 which provided that a QTIP election made by an estate will be respected even if the election is not required to reduce federal estate taxes. Previously the position of the IRS was that a QTIP election that was not necessary to reduce federal estate taxes would be ignored. This earlier position, stated in Revenue Procedure 2001-38, was meant to protect estates from the potentially significant and adverse estate tax consequences of unnecessary QTIP elections in a pre-portability era. After the introduction of portability (see chapter on federal estate taxes), this earlier position caused concern among practitioners who worried about the validity of a QTIP election on a federal return filed solely for the purpose of electing portability of the deceased spouse's unused exemption. This new Revenue Procedure puts to rest those concerns and makes clear that these elections will be respected.

C. SPOUSAL ELECTIVE SHARE

If a surviving spouse is omitted or is not adequately provided for in the client's testamentary documents, New Jersey permits the surviving spouse with a right to take an elective share equal to one-third of the decedent's augmented estate, subject to certain limitations. This elective share does not apply if the decedent and his or her surviving spouse were living separately at the time of death, either as the result of judgment of divorce from bed and board or under circumstances which would have given rise to a cause of action for divorce or nullity of marriage to a decedent prior to his death under the laws of this State.[50]

D. INHERITANCE TAX PLANNING

The New Jersey Transfer Inheritance Tax system commenced in 1892. It presently applies to the transfer of real or personal property in excess of $500 in the aggregate from a decedent to a

[50] N.J.S.A. 3B:8-1.

beneficiary.[51] The inheritance tax return must be filed and the tax paid within eight months of the decedent's date of death (note that this deadline is shorter than the 9 month deadline available for filing federal and state estate tax returns and the payment of those taxes).

The tax is imposed on a resident decedent for the transfer of real or tangible personal property located in New Jersey or intangible personal property, wherever it is situated. The tax is also imposed on a nonresident decedent for the transfer of real or tangible personal property located in New Jersey. The tax does not apply to intangible personal property of a nonresident decedent. In addition, the following transfers are exempt from the inheritance tax:

- All transfers having an aggregate value under $500;
- Life insurance proceeds paid to a named beneficiary;
- Charitable transfers for the use of any educational institution, church, hospital, orphan asylum, public library, etc.;
- Transfers for public purposes made to New Jersey or any political subdivision thereof;
- Federal civil service retirement benefits payable to a beneficiary other than the estate, executor, or administrator;
- Annuities payable to survivors of military retirees; and
- Qualified employment annuities paid to a surviving spouse, civil union partner, or domestic partner

The inheritance tax rate is based on the relationship of the decedent to the beneficiary and ranges from 11%-16%. The statute sets forth 5 different classes of beneficiaries – Class A, Class B. Class C, Class D, and Class E – for purposes of determining the tax rate. The tax rate is then based on the beneficiary's class and the aggregate amount of the transfer.

Class A beneficiaries include a decedent's surviving spouse/civil union partner, surviving domestic partner, children, stepchildren, parents, grandparents or grandchildren. This class is exempt from the inheritance tax and it is generally not necessary to file an Inheritance Tax return for transfers to such individuals.

Class B was deleted by an amendment to the statute in 1963.

Class C beneficiaries include the brother or sister of the decedent; the husband, wife, or widow(er) of a child of the decedent; and the civil union partner or surviving civil union partner of a child of decedent. Transfers to Class C beneficiaries are taxed at 11%–16%, with an exemption for the first $25,000 transferred to each such beneficiary.

---

[51] N.J.S.A. 54:33-1 *et seq*.

Class D beneficiaries include all individuals not otherwise classified and are taxed at 15%–16%, with an exemption for the first $500 transferred to each such beneficiary.

Class E beneficiaries include transfers to the State of New Jersey or any of its political subdivisions for public or charitable purposes, an educational institution (subject to certain limitations), church, hospital, orphan asylum, public library, and certain other nonprofit agencies. This class is exempt from the inheritance tax.

Chapter 5
Planning for Incapacity

Clients often overlook the importance of planning for incapacity as part of their basic estate planning. The attorney should discuss the need for this type of planning with the client and should work with the client to determine the person or persons who will serve as the client's agent in the event of incapacity. Incapacity can happen at any age, so planning for incapacity is fundamental for all clients, not just the elderly or infirm.

It is much easier to plan for incapacity in advance while the client is healthy and of sound mind. If the client is already incapacitated and has not appointed an agent, a guardianship or conservatorship proceeding must be instituted in order to have the court appoint individuals or entities to make financial, legal, medical and residential decisions for the incapacitated person. These proceedings can be very costly. More importantly, they may result in the appointment of individuals or entities that the incapacitated person may not have chosen.

There are two major areas of a client's life that we try to address as part of incapacity planning. The first is with respect to managing the client's financial and property matters. The second is with respect to the client's medical matters. While there are many routes that may be taken to deal with incapacity, the attorney can assist by counseling with respect to and preparing a power of attorney and an advance directive for health care (a proxy directive and living will). A revocable trust may also be used as a way to plan for future incapacity.

A. POWER OF ATTORNEY

A power of attorney is a document in which an individual (known as the principal) appoints an "attorney-in-fact" to act on behalf of the principal with respect to his or her financial and property matters. The power of attorney is formal evidence of the relationship between the principal and the attorney-in-fact and is relied upon by third parties in conducting business with the attorney-in-fact.

The power of attorney may be limited in scope to deal with specific decisions (a "limited power of attorney" - e.g., with respect to certain real property interests) or it may be much broader in application. Where the power of attorney is being drafted in advance to plan for incapacity, it should be as broad and general as the client will permit in order to allow the attorney-in-fact to do whatever is necessary to act on the principal's behalf with respect to his or her assets (a "general power of attorney").

In New Jersey, the Revised Durable Power of Attorney Act [52]requires that the power of attorney must be in writing and acknowledged.[53] Although witnessing is not required, it is helpful to have at least one (and preferably two) witnesses in the event the power ever needs to be recorded. In that regard, if the power will need to be recorded, the name and signature of the preparer should appear on the front page and the names of the witnesses should be typed in below their signatures.[54] In addition, although there is no requirement that the attorney-in-fact sign the power of attorney, having the attorney-in-fact's signature on the form will make it easier for it to be identified upon presentation of the power of attorney to a third party.

> PRACTICE TIP: The power of attorney should be prepared and executed in a manner that would allow it to serve for any purpose, including recording. Accordingly, it should be in writing, signed by 2 disinterested witnesses, and acknowledged. The name and signature of the preparer should appear on the front page and the names of the witnesses should be typed in below their signatures.

A "durable" power of attorney, which is authorized by the statute, survives the disability or incapacity of the principal.[55] In order to be durable, the document must expressly provide that "this power of attorney shall not be affected by subsequent disability or incapacity of the principal, or lapse of time," or similar words to show that the principal intends for the power of attorney to be effective notwithstanding the principal's subsequent disability or incapacity.[56] Given the importance of the power of attorney in incapacity planning, this language should always be included.

Aside from a few requirements as to the wording necessary in order the grant the attorney-in-fact the authority to exercise certain powers (e.g., the authority to conduct banking transactions[57]) or that certain powers be expressly provided for in the document (e.g., the power to make a gift[58]) the statute is mostly silent as to any specific form or drafting requirements for the power of attorney. For this reason, it is advisable when preparing a power of attorney to expressly provide for any and all powers that may be needed by the attorney-in-fact.

---

[52] N.J.S.A. 46:2B-8.1, *et. seq.*
[53] N.J.S.A. 46:2B-8.9.
[54] See N.J.S.A. 46:15-1.1 for what constitutes recordable form.
[55] N.J.S.A. 46:2B-8.1.
[56] N.J.S.A. 46:2B-8.2(b) .
[57] See N.J.S.A. 46:2B-11 which provides that the following language should be used in order to provide the attorney-in-fact with the requisite banking powers "to conduct banking transactions as set forth in Section 2 of P.L. 1991, Chapter 95 (C.46:2b-11)".
[58] See N.J.S.A. 46:2B-8.13(a).

The power of attorney may be drafted to be effective immediately or only upon the disability or incapacity of the principal. This latter power of attorney is known as a "springing" power of attorney. In order to make the power of attorney springing, language must be included to provide that "this power of attorney shall become effective upon the disability or incapacity of the principal"[59] and a method of determining incapacity or disability should be clearly set forth. In addition, if the power of attorney is only effective in the event of incapacity, HIPAA language should be included which permits the attorney-in-fact to be authorized to receive medical information with respect to the principal.

One of the major issues with using a springing power of attorney is that incapacity has to be determined before the power is effective. Third parties will want evidence of the incapacity before working with the attorney-in-fact, which can become quite cumbersome to have to show each time. To avoid this issue, the springing power of attorney should expressly define how incapacity is to be determined and state the documentation that a third party can rely on.

It is common for the principal to name a spouse or other family members to the role of attorney-in-fact, but this is not a requirement. Sometimes it may be a good friend that is appointed to this role, or someone who is acting in other fiduciary capacities with respect to the principal's estate planning (e.g., executor, trustee, etc.). Due to the great authority that is being conferred, the attorney-in-fact should be an individual that that principal trusts implicitly (particularly where the power is effective immediately).

The principal can name multiple attorneys-in-fact.[60] In this case, unless the power of attorney provides otherwise, if one or more attorneys-in-fact fails to serve as a result of death, resignation or disability, those attorneys-in-fact who remain may continue to exercise all authority granted.. The power of attorney may provide that the attorneys-in-fact may act severally or separately. Alternatively, it may provide that the attorneys-in-fact shall act jointly, in which case all appointed and remaining attorneys-in-fact must concur in order to exercise any power. If the power of attorney does not expressly provide whether the attorneys-in-fact are to act severally or separately, or are to act jointly, such attorneys-in-fact must act jointly. The power of attorney may also provide that the attorneys-in-fact act successively. Unless the power of attorney otherwise provides for the conditions under which a successor is qualified to act, the successor may act only upon the death, the written resignation, or the disability of the predecessor named attorney-in-fact.

[59] N.J.S.A. 46:2B-8.2(b).
[60] N.J.S.A. 46:2B-8.7.

The power of attorney remains effective until the earlier of revocation or death of the principal. In order to be revoked, the attorney-in-fact must have notice of the revocation.[61] A power of attorney is revoked when the principal has caused all executed originals of the power of attorney to be physically destroyed, when the principal has signed and caused to be acknowledged in the manner set forth in R.S.46:14-2.1 a written instrument of revocation, or when the principal has delivered to the attorney-in-fact a written revocation.[62] Unless expressly provided, the subsequent execution of another power of attorney does not revoke a power of attorney.

There are two main issues that attorneys have encountered with power of attorney forms in the past. First, if the power of attorney was signed several years before it needed to be used, certain institutions have been known to reject the power on the basis of it being "stale".[63] In order to avoid this situation, the client may want to execute a new power of attorney every few years in an effort to keep it fresh. Second, certain institutions will only accept a power of attorney that is on their own form. If the client has major assets at any particular institution, it is advisable to have the client check whether that institution will accept the power of attorney as drafted or whether the institution's form must be used to deal with the assets located there. If a power of attorney is not accepted by an institution at a time when the principal is already incapacitated, a court proceeding will need to be instituted to appoint someone who can handle the principal's assets, thereby defeating the whole purpose of the power of attorney. For the above reasons, some attorneys prefer to use a revocable living trust to help deal with issues of incapacity, as discussed later in this chapter.

B. ADVANCE DIRECTIVES FOR HEALTH CARE

The New Jersey Advance Directives for Health Care Act[64] was enacted in consideration of the fundamental right possessed by competent adults, in collaboration with their health care providers, to control decisions about their own health care and to make voluntary, informed choices to accept, to reject, or to choose among alternative courses of medical and surgical treatment.[65]

This statute permits the use of an advance directive for health care to set forth the declarant's treatment philosophy and to appoint an agent, known as a health care representative, to make the declarant's medical decisions in the event the declarant is unable to do so. "Advance directive

[61] N.J.S.A. 46:2B-8.5.
[62] N.J.S.A. 46:2B-10.
[63] See N.J.S.A. 46:2B-10 which provides that if a spouse or blood relative is named as attorney-in-fact, the power should be honored regardless of when written. For all others, there is a sliding 10 year period after which the document may be deemed stale.
[64] N.J.S.A. 26:2H-53, *et. seq*.
[65].N.J.S.A. 26:2H-54(a).

for health care" or "advance directive" means a writing executed in accordance with the requirements of the act, and may include a proxy directive or an instruction directive, or both. [66] A “proxy directive” is a writing which designates a health care representative to make medical decisions for the declarant in the event the declarant subsequently lacks decision making capacity. The declarant will typically name his or her spouse, a close family member, or a good friend as health care representative, although any competent adult may serve.[67] A declarant may designate one or more alternate health care representatives, listed in order of priority.

If the declarant wishes to name a physician, the physician can serve as health care representative only if he or she is not concurrently serving as the declarant’s attending physician.[68] An operator, administrator or employee of a health care institution in which the declarant is a patient or resident cannot serve as the declarant's health care representative unless the operator, administrator or employee is related to the declarant by blood, marriage, domestic partnership or adoption.[69]

The proxy directive should be drafted to include HIPAA language which authorizes the agent to speak to the declarant’s physician about the declarant’s medical condition..

An “instruction directive” or “living will” provides a statement of personal wishes regarding health care in the event of loss of decision making capacity. A declarant may execute an instruction directive stating the declarant's general treatment philosophy and objectives and/or the declarant's specific wishes regarding the provision, withholding or withdrawal of any form of health care, including life-sustaining treatment.[70] Life-sustaining treatment" means the use of any medical device or procedure, artificially provided fluids and nutrition, drugs, surgery or therapy that uses mechanical or other artificial means to sustain, restore or supplant a vital bodily function, and thereby increase the expected life span of a patient.[71] If the declarant is female, she may include information as to what effect the advance directive will have if she is pregnant.

There is no one form for a living will and it should be drafted with careful consideration of each client’s wishes and desires. Some clients want to be removed from any life sustaining treatment and desire the administration of pain relief even if it may shorten the course of their remaining life (assuming they are already terminally ill). Other clients wish to stay on life support as long as their families can afford the financial burden. Still other clients have religious beliefs with respect to how this should be handled and would like those beliefs respected by incorporating them into a living will.

---

[66] N.J.S.A. 26:2H-55.
[67] N.J.S.A. 26:2H-58(a)(1).
[68] N.J.S.A. 26:2H-58(a)(2)
[69] Id.
[70] N.J.S.A. 26:2H-58(b).
[71] N.J.S.A. 26:2H-55.

While not required, an instruction directive may be executed contemporaneously with, or be attached to, a proxy directive.

In order to be properly executed, an advance directive must be:

2) signed and dated by, or at the direction of, the declarant in the presence of two subscribing adult witnesses who must attest that the declarant is of sound mind and free of duress and undue influence, [72]or

3) signed and dated by, or at the direction of, the declarant and acknowledged by the declarant before a notary public, attorney at law, or other person authorized to administer oaths.

A designated health care representative cannot act as a witness to the execution of an advance directive.

The advance directive becomes operative when (1) it is transmitted to the attending physician or to the health care institution, and (2) it is determined that the patient lacks capacity to make a particular health care decision.[73] It is the attending physician who determines whether the patient lacks capacity to make a particular health care decision. The determination must be stated in writing and must include the attending physician's opinion concerning the nature, cause, extent, and probable duration of the patient's incapacity.[74] Subject to certain exceptions, the attending physician's determination of a lack of decision making capacity must also be confirmed by one or more physicians in writing.[75]

An advance directive may be revoked in either of the following ways:

1) Notification, orally or in writing, to the health care representative, physician, nurse or other health care professional, or other reliable witness, or by any other act evidencing an intent to revoke the document; or

2) Execution of a subsequent proxy directive or instruction directive, or both, with the proper formalities for valid execution.[76]

In addition, if the declarant's spouse or domestic partner is named as health care representative, the statute provides for automatic revocation of such designation upon divorce or legal separation, in the case of a spouse, or in the case of termination of a domestic partnership.[77]

[72] N.J.S.A. 26:2H-56.
[73] N.J.S.A. 26:2H-59(a).
[74] N.J.S.A. 26:2H-60(a).
[75] N.J.S.A. 26:2H-60(b).
[76] N.J.S.A. 26:2H-57(b).
[77] N.J.S.A. 26:2H-57(c).

C. REVOCABLE LIVING TRUSTS

In order to avoid any possibility that a durable power of attorney may not be accepted when a client does in fact become incapacitated, some attorneys prefer to plan with a revocable living trust. The mechanics of a revocable living trust have already been discussed earlier in this outline and so will not be repeated here.

The ability to appoint successor trustees who can step into the shoes of the client upon a finding of disability and with the ease of facilitating the transfer of authority to the successor trustee are what make the revocable living trust attractive for incapacity planning. The client gets to select the people or institutions that he or she believes will best handle the financial assets in the estate.

The trust agreement should clearly define incapacity and the process by which a trustee is to be removed if found to be incapacitated. Because of the difficulty associated with getting an incapacitated person to remove himself or herself from the position of trustee, the trust agreement can also provide that a finding of incapacity is not required for removal if the successor trustee believes the trustee is incapacitated, but if the trustee disagrees then a doctor's note must be provided to that effect within a set number of days.

During the client's life, the dispositive provisions of the trust can provide for distributions of income or some combination of income and corpus. The trust agreement can also specify whether the client's spouse and any other beneficiaries can receive distributions from the trust during the period the client is incapacitated.

D. GUARDIANSHIPS

A guardianship proceeding will need to be instituted in the event the client is incapacitated and does not have an agent appointed to manage his or her affairs. In New Jersey, guardianship actions are filed in the Superior Court, Chancery Division, and are governed by Rule 4:86 and N.J.S.A. 3B:12-24 *et seq.*

A guardian will only be appointed if the Court determines that the client qualifies as an "incapacitated individual." An "incapacitated individual" is defined as an individual who is impaired by reason of mental illness or mental deficiency to the extent that he or she lacks sufficient capacity to govern himself or herself and manage his or her affairs.[78] The term "incapacitated individual" is also used to designate an individual who is impaired by reason of physical illness or disability, chronic use of drugs, chronic alcoholism or other cause (except

[78] N.J.S.A. 3B:1-2.

minority) to the extent that he lacks sufficient capacity to govern himself and manage his affairs.[79]

A guardianship action is initiated by filing a petition by way of Verified Complaint and Order to Show Cause with the Court, along with the reports of two physicians certifying that the alleged incapacitated person ("AIP") is unable to make decisions for himself or herself. An inventory of the AIP's assets, together with any actual or anticipated sources of income, must also be filed with the Verified Complaint. The petition should ask the court to determine whether the AIP is incapacitated and, if so, who should serve as the guardian. The petition should also propose the guardian to be appointed if the Court concludes that the AIP is incapacitated.

The Court will appoint an attorney to represent the AIP. This attorney will conduct a thorough review of the relevant issues, will meet with the AIP and other people having personal knowledge of the AIPs condition and property, and will prepare a report for the court summarizing the attorney's findings with respect to the AIP's competence and the suitability of the proposed guardian.

After all the reports are filed, the judge will review the paperwork and the Court will decide whether to hold a hearing. If the guardianship is uncontested, no or only limited testimony may be required. If, however, the guardianship is contested, a full hearing will be required. Usually, the Court will issue an Order at the hearing granting or denying the petition. If the AIP is adjudicated incapacitated, he or she becomes a ward of the Court and a guardian will be appointed.

If the court finds that an individual is incapacitated and does not have capacity to govern himself or manage his affairs, the court may appoint a general guardian to exercise all rights and powers of the incapacitated person.[80] If, on the other hand, the court finds that an individual is incapacitated and lacks the capacity to do some, but not all, of the tasks necessary to care for himself, the court may appoint a limited guardian of the person, limited guardian of the estate, or limited guardian of both the person and estate.[81]

Once a guardian has been appointed, he or she must appear before the county Surrogate to qualify and to receive Letters of Guardianship. The statute provides that Letters of Guardianship will be granted to the spouse or domestic partner of the alleged incapacitated person if the spouse is living with such person as man and wife or as a domestic partner at the time the incapacitation arose, or to the incapacitated person's heirs, or friends, or thereafter first consideration will be given to the Office of the Public Guardian for Elderly Adults in the case of adults within the

---

[79] Id.
[80] N.J.S.A. 3B;12-24.1(a).
[81] N.J.S.A. 3B;12-24.1(b).

statutory mandate of the office, or if none of them will accept the letters or it is proven to the court that no appointment from among them will be to the best interest of the incapacitated person or the estate, then to any other proper person as will accept the same, and if applicable, in accordance with the professional guardianship requirements of P.L.2005, c.370 (C.52:27G-32 et al.).[82]

Irrespective of whether a general or limited guardian is appointed, the guardian of the estate will need to furnish a bond unless relieved from doing so by the court.[83] The bond requirement is there to protect the ward against any property loss that could result from an act of misfeasance or malfeasance committed by the guardian in relation to his or her service. Once appointed, the guardian must file an inventory of the ward's income and assets with the Surrogate's office[84] and must annually file a guardianship report detailing the status of the ward's condition, health, income and assets.

If the ward recovers capacity, the Superior Court may, on summary action filed by the ward or the guardian, adjudicate that the ward has returned to full or partial competency and restore to that person his civil rights and estate as it exists at the time of the return to competency if the court is satisfied that the person has recovered his sound reason and is fit to govern himself and manage his affairs.[85]

E. PLANNING FOR THE INCAPACITY OF A BENEFICIARY

Another often overlooked area of planning involves planning for the current or potential incapacity of any beneficiary of the client's estate plan. When advising the client, it is important to ask whether any intended beneficiary has special needs which may need to be addressed in the estate plan. Even if there is no beneficiary today who has special needs, it is entirely possible that such circumstances may arise in the future by the time a beneficiary is paid out his or her inheritance.

If an inheritance is distributed to a beneficiary who otherwise qualifies for governmental benefits, the beneficiary may lose the governmental benefits. If the inheritance is not sufficient to cover the amount that was previously received from the government, the beneficiary will be seriously disadvantaged.

One way to plan for this type of situation is to have language in the dispositive provisions of the governing instrument which provide for assets that would otherwise be distributed to an

[82] N.J.S.A. 3B:12-25.
[83] N.J.S.A. 3B:12-24.1(a) and N.J.S.A. 3B:12-24.1(b).
[84] N.J.S.A. 3B:16-8.
[85] N.J.S.A. 3B: 12-28.

incapacitated beneficiary to instead be held in trust in a manner that does not disqualify the beneficiary from receiving governmental benefits until the incapacity is removed. The beneficiary would only be entitled to discretionary distributions for supplemental needs from the trust in such instance. This type of trust is called a “supplemental needs trust”. It often is (but should not be) confused with a “special needs trust”. Among the differences between these two types of trusts are that a special needs trust is one which is established by statute and court order for a beneficiary with his or her own funds whereas a supplemental needs trust is established with third party trusts. Funds that are not expended from a special needs trust must be used to repay the government for certain benefits when the beneficiary dies. This is not the case with a supplemental needs trust, which may distribute any remaining assets in accordance with the terms of the trust.

Chapter 6
Beyond the Basics

Once a basic estate plan has been established for the client, additional planning may be needed in order to address special situations that can arise from the client's assets or goals.

There are a host of tools in every estate planner's toolbox to help the client achieve his or her goals of transfer tax minimization, asset protection, business succession planning, and charitable planning.

While it is not possible to address every situation in this outline, some of the important factors and planning tools relating to each of these areas are addressed below.

A. TRANSFER TAX MINIMIZATION

Almost every client with a taxable estate is interested in utilizing legal strategies to reduce the impact of transfer taxes upon his or her death. To reduce the size of the estate, the client should consider making a completed gift of appropriate assets to a person or to an irrevocable trust.

As discussed earlier in this outline, irrevocable trusts provide a means for a client to transfer assets outside of his or her estate while at the same time having control over how those assets ultimately get distributed to the beneficiaries. The best assets to transfer into an irrevocable trust are those which are likely to highly appreciate by the time the client passes away. Because assets that are gifted during an individual's lifetime have a transferred basis to the transferee (unlike the step up in basis that is given to assets that pass upon a decedent's death), assets with a high basis are better candidates for transfer.

One of the most prevalent techniques in planning with irrevocable trusts is to use them to hold life insurance policies on the life of the grantor. Generally, the face value of life insurance is included in the taxable estate of a decedent if the decedent owned the policy (or retained rights of ownership) and was the insured under the policy. In order to avoid this potentially costly result, life insurance can be transferred into a newly created irrevocable trust or can be purchased within the irrevocable trust. If an existing life insurance policy is transferred into the irrevocable trust, there will be a gift equal to the interpolated terminal reserve value of the policy on the date of the transfer. This value is based on the cash build up in the policy. The client must survive for a period of 3 years after the transfer in order to avoid having the policies included back in his or her estate.

The trust can be established to mimic the beneficiary designations so that the surviving spouse is the initial beneficiary during his or her lifetime and the children are the remainder beneficiaries (similar to the trusts that have been discussed in Chapter 2, above).

In addition to transferring out life insurance policies from the estate, clients may wish to gift assets for which valuation discounts for lack of control and lack of marketability are available to reduce the amount of the client's lifetime gift exemption used towards the transfer. Examples of such assets include interests in closely held businesses and in real property.

B. ASSET PROTECTION PLANNING

Asset protection planning can be described as employing legal strategies to preserve and protect the client's assets. The goal of asset protection planning is generally to put as many obstacles in place as possible so that a future creditor either retreats or decides to settle its claim.

Before commencing this type of planning, the attorney must be careful to ensure that none of the strategies employed could be construed as a "fraudulent transfer" or a "fraudulent conveyance" – essentially an attempt to defraud or hinder known or foreseeable creditors. If there is a known or foreseeable creditor, it may be too late for the client to plan unless the client has assets sufficiently in excess of the amount of the potential claim.

The attorney should obtain an Affidavit of Solvency before commencing asset protection planning. The Affidavit may provide the attorney with some protection against any claims that he or she assisted the client in effecting a fraudulent transfer.

Basic asset protection planning may simply involve obtaining adequate insurance, shifting assets into protected assets (such as an IRA), and shifting assets into the name of another outright. Depending on how serious the threat of a future claim is perceived to be, the client may utilize one or more of the following strategies

1. *Irrevocable trust*. If the client has sufficient gift tax exemption available, he or she may wish to consider transferring assets into an irrevocable trust for the benefit of the client's spouse during the spouse's lifetime (a spousal lifetime access trust, or "SLAT"), and thereafter to remainder beneficiaries. For so long as the client's spouse is alive and married to the client, it is possible that the client could also benefit from trust distributions made to the client's spouse. Of course, if the client's spouse were to predecease the client or divorce the client, these distributions would no longer be available.

2. *Limited liability company* – If the client was not ready to transfer his or her assets to another where the client could not directly benefit (as would be the case with a SLAT), another alternative is to form a limited liability company ("LLC") to hold some (but not all) of the client's assets. Ideally, the LLC would consist of more than a single member. The LLC structure should afford protection for claims that are brought from within the LLC and potentially can protect for claims brought outside the LLC. The examples below may clarify the difference between inside and outside claims.

> Example 1: Assume the client transferred a rental property to the LLC and a tenant was subsequently injured on the property. Any claim that would be brought by the tenant against the LLC is considered an inside claim (a claim arising within the LLC structure) and should be limited to the assets held by the LLC, assuming the corporate formalities of the LLC have been properly observed. The claim should not extend to any assets that the client may own outside of the LLC.
>
> Example 2: Assume the client was driving and killed a pedestrian. If the pedestrian's estate were to sue the client, an outside claim would be brought against the LLC interest owned by the client as well as all other assets in the client's estate.

Whether or not the LLC structure in Example 2 above provides protection against the outside creditor will depend on whether the LLC was organized in a state that has a charging order only statute or whether other remedies are available against the LLC interest (e.g., foreclosure, liquidation, forced sale). If the LLC statute provides that a charging order is the exclusive remedy, then the creditor would only be able to receive the client's financial rights in the LLC and could not force distributions from the LLC or a liquidation of the LLC interest in order to reach the underlying assets. In this case, the LLC structure would afford asset protection as the creditor likely does not want to step into the client's shoes with the possibility of being allocated phantom income from the entity and not knowing when distributions will be received. The creditor is much more likely to want to settle the matter in this instance to at least receive something immediately.

If, instead, state law provides that the creditor could foreclose on the LLC interest or obtain a court order to sell the LLC interest, much less creditor protection is offered from the LLC structure.

3. *Domestic asset protection trust* – a domestic asset protection trust (DAPT) is a self-settled trust that is established in one of the several jurisdictions that presently permit them (including Alaska, Delaware, Nevada, South Dakota, Ohio, Tennessee, Wyoming, Rhode Island, New Hampshire, Utah, Missouri, Hawaii, Virginia, Oklahoma and Colorado).

DAPTs are an attractive vehicle for asset protection because they permit the grantor/settlor of a trust to be a discretionary beneficiary of the trust while at the same time protecting the assets of the trust from any creditors of the grantor/settlor. Generally, DAPTs are irrevocable trusts with spendthrift provisions. In order to create a DAPT in a particular state, it is generally necessary to appoint a resident trustee (which may be an administrative trustee in certain circumstances). The trustee may be given full discretion as to how the trust assets are to be distributed.

Transfers to a DAPT are subject to a statute of limitations period which must expire before the transfer is protected from future creditors. A separate statute of limitations may exist for preexisting creditors.

To garner further protection, the client may wish to fund the DAPT with the LLC interest (assuming the LLC is established in a charging order only jurisdiction). This provides two layers of protection against a potential creditor.

There is some concern that DAPTs may not be respected if they are established in a state where the settlor is not a resident. This concern derives from the Full Faith and Credit Clause of the U.S. Constitution which basically stands for the proposition that the courts of one state must recognize judgments rendered by another state. Accordingly, if a judgment is entered against the grantor/settlor in the state where he or she resides, it is possible that the judgment may be enforced in the state where the DAPT is established.

4. *Offshore Asset Protection Trust* – The offshore asset protection trust (OAPT) was the genesis for the domestic asset protection trust. An offshore asset protection trust is a trust that is established in another country which recognizes self-settled trusts (e.g., the Cook Islands, Nevis, etc.). Typically, these countries have very strong laws to preserve the privacy of the trust and they will not enforce the judgment of a foreign jurisdiction over the trust. There is successful case law testing the offshore asset protection trust, but the debtors in those cases typically were found to be in contempt of court and spent some time in jail for refusing to require assets to be brought back to the United States.

C. BUSINESS SUCCESSION PLANNING

If a client has a family business or other closely held business interest, this asset is often the single most valuable asset in the estate. Business succession planning generally involves determining how the business interest will pass upon the client's retirement or death and how estate taxes and other transfer costs will be paid given the illiquid nature of most business interests.

Depending on the corporate form of the business, there may be a shareholder's agreement or an operating agreement which specifies how interests in the company can be transferred. This agreement can provide tremendous guidance in determining the right plan. Unfortunately, most small businesses do not have such documentation in place.

There are two types of situations that we typically see:

1) A family business where the client would like to transfer the business upon retirement or death to one or more members of the family or key employees, and
2) A closely held business between the client and one or more other individuals. In this situation, it may not make sense to transfer the business interest to the client's family. Instead, the planning may focus on ensuring that the client or his or her family gets a fair price for the client's business interest at the point of transition.

In the context of estate planning for a client with a family business, the attorney will want to discover who the client would like to have run the company if the client unexpectedly passes away. This may be the client's spouse, certain children, or even a key employee. If the client intends to leave the business to one child and not another, the estate plan should provide a way for the gifts to the children to be equalized as much as possible (assuming that is the client's wish). If the client intends for a non-family member to take up the reins, different options must be considered in order to transfer ownership to that non-family member in a tax efficient yet compensatory manner for the family members who will not receive the business.

Some of the tools commonly used to plan for business succession in the foregoing situations include buy sell agreements and life insurance, family limited partnerships and/or limited liability companies, revocable and irrevocable trusts, incentive stock option plans, nonqualified plans, ESOPs, deferred compensation plans, qualified retirement plans, non-compete agreements, and management or consultation agreements. The proper mix of these will depend on each client's goals and family situation, the value of the company, and the make-up of its employees.

D. CHARITABLE PLANNING

For the client who is charitably inclined, charitable planning can greatly reduce estate and/or income tax liability while at the same time satisfying the client's philanthropic goals. There are numerous vehicles for making charitable transfers, either during lifetime or at death. This outline covers some of the more popular ways in which charitable planning is included in the client's estate plan. It should be noted for this purpose we are discussing charities that qualify as exempt organization under IRC Section501(c)(3).

1. *Outright Gifts*. A client may wish to make an outright gift of certain assets or a percentage of the residue of his or her estate to a named charity. This is the simplest method of charitable planning. If the gift is made during the client's lifetime, a limited charitable deduction may be permitted on the client's income tax return, with excess amounts carried forward for a maximum of 5 years. If the gift is made at death, an unlimited charitable deduction is allowed against the client's taxable estate.
2. *Donor Advised Funds*. A donor advised fund is a separately identified fund or account that is operated by a nonprofit, section 501(c)(3) organization. The fund or account is comprised of contributions made by several individual donors. The nonprofit has control over the contribution once it is made, but the donor retains the ability to advise with respect to the distribution of funds and the investment of assets in the account. A client would normally make a gift to a donor advised fund during his or her lifetime in lieu of making an outright gift or setting up a private foundation. The client is entitled to the limited income tax charitable deduction for the gift and can carry forward any excess for a set number of years.
3. *Private Foundation.* A private foundation is a 501(c)(3) organization established by the client for purposes of making a large endowment which can be used towards more than one charitable entity and/or goal. A private foundation has several restrictions on how it must be administered and assets distributed. For this reason, a private foundation generally only makes sense if a large gift is to be made and if the client, and the client's family, all intend to be involved with the foundation going forward. If a gift is made to a private foundation during the client's lifetime, the same income tax charitable deductions discussed above will apply. If the private foundation is established in the client's will, the unlimited charitable deduction will apply towards contributions made to the private foundation.
4. *Charitable Lead Trust*. A charitable lead trust is a split interest trust that is established for the benefit of a 501(c)(3) charity (or charities) and individual beneficiaries. During the term of the trust, a fixed annuity or unitrust amount is paid to the designated charitable beneficiary. At the end of the trust term, the remainder is paid to the individual beneficiaries (generally children or grandchildren) designated by the client. The client is treated as having made a taxable gift at the time of the transfer to the trust. The amount

of the gift is determined by reducing the value of the assets initially transferred to the trust by the net present value of the stream of payments that will be received by the charity over the term of the trust.

5. *Charitable Remainder Trust*. A charitable remainder trust is also a split interest trust. This trust is established for the benefit of a qualified charity and the donor. The donor receives either a fixed or variable annuity for a period of time not to exceed 20 years or the life or lives of designated individuals (e.g., the donor and the donor's spouse), after which time the remainder goes to the charity. If the trust is a charitable remainder annuity trust, contributions are only allowed at the time the trust is initially funded. If the trust is a charitable remainder unitrust, additional contributions may be made during the trust term.

Dana A. Bennett, Esq., LL.M. (taxation)
Bennett & Wyatt LLC
3 Harding Road
Suite E
Red Bank, New Jersey 07701
732-268-7520
dbennett@bennettwyatt.com

Dana A. Bennett is a partner at Bennett & Wyatt, LLC with offices in Red Bank and Lakewood. She devotes her practice to estate planning, probate and estate administration, estate and gift tax matters, income tax planning for trusts and estates and charitable planning.

Ms. Bennett is admitted to practice in New Jersey and New York. She is a fellow of the American College of Trust and Estate Counsel (ACTEC) and Chair of the Board of Consultors of the Real Property, Trust and Estate Law Section of the New Jersey State Bar Association. She is also a current trustee and former chair of the Monmouth County Bar Association's Probate and Administration Committee and is a member of the American and New York Bar Associations. Ms. Bennett is also a member and former President of the Estate and Financial Planning Council of Central New Jersey.

Ms. Bennett received her B.A., cum laude, from Villanova University, her J.D. from Seton Hall University School of Law and her LL.M. in Taxation from New York University School of Law.

Tara S. Sinha is a Partner of Witman Stadtmauer, P.A., in Florham Park, New Jersey. She concentrates her practice in the areas of estate planning and administration, estate and probate litigation, and federal and state taxation.

Ms. Sinha is admitted to practice in the States of New Jersey and New York, as well as the United States District Court for the District of New Jersey. She is a Fellow of the American College of Trust and Estate Counsel (“ACTEC”) and serves on the Board of Consultors of the Real Property, Trust and Estate Law Section of the New Jersey State Bar Association. Ms. Sinha is a member of the Estate Planning Council of Northern New Jersey as well as the New Jersey and Morris County Bar Associations. Ms. Sinha has been published in the New Jersey Law Journal and has also lectured for the New Jersey Institute for Continuing Legal Education, New York City Bar, and other organizations.

Ms. Sinha received her B.S. in Administration of Justice from Rutgers College and her J.D. from Rutgers School of Law - Newark, where she was the Senior Articles Editor of the Women’s Rights Law Reporter and a Teaching Assistant for the Legal Research and Writing program. She was a Law Clerk to the Honorable Walter R. Barisonek, J.S.C.

Kevin R. Centurrino is an associate of Berkowitz, Lichtstein, Kuritsky, Giasullo and Gross, LLC, in Roseland, New Jersey, where he concentrates his practice in estate planning, estate administration and Medicaid planning.

Admitted to practice in New Jersey, New York and Pennsylvania, and before the United States District Court for the District of New Jersey, Mr. Centurrino is a member of the Estate Planning Council of Northern New Jersey, the New Jersey State Bar Association and the Morris County Bar Association. He has lectured for the New Jersey Institute for Continuing Legal Education, the New York City Bar Association and other professional organizations, and has authored numerous articles for the New Jersey Law Journal, including "Warning: 529 Accounts May Be Subject to NJ Inheritance Tax" and "Taking Advantage of FDIC Insurance Loopholes Could Impede Your Estate Plan".

Mr. Centurrino received his B.A. from Moravian College and his J.D. from Widener University School of Law, where he was a member of the Moot Court Honor Society.