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ESTATE OF MARY VAN RIPER,
Plaintiff/Petitioner,
v.
NEW JERSEY DIVISION OF TAXATION
Defendant/Respondent.

: SUPREME COURT OF NEW JERSEY
: Docket No.: 082000
:
: On Appeal From:
: Superior Court of New Jersey
: Appellate Division
: Docket No.: A-3024-16T4
:
: Civil Action
:
: Sat Below:
: Hon. Joseph L. Yannotti, P.J.A.D.
: Hon. Robert J. Gilson, P.J.A.D.
: Hon. Arnold L. Natali, J.A.D.
:
:

BRIEF OF *AMICUS CURIAE* NEW JERSEY STATE BAR ASSOCIATION
IN SUPPORT OF PETITION FOR CERTIFICATION

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PRELIMINARY STATEMENT

This matter involves fundamental questions of property law, trust law and inheritance tax law. The Appellate Division's unprecedented expansion of the concept of tenancy by the entirety, as applied to transfers to and from a trust, creates new law that is inconsistent with settled legal principles. The result will be uncertainty and confusion about the effectiveness of well-established and commonly used estate planning techniques.

In this case, Walter and Mary Van Riper transferred their home to an irrevocable trust. The trust agreement directed that Mary and Walter be permitted to use the trust assets until the death of the survivor of them. Walter died within a few weeks of the agreement being established. A New Jersey inheritance tax return was filed with a timely reporting of the creation of the trust. When Mary died six years later, the Director imposed inheritance tax on the entire value of the home in Mary's estate. The Tax Court upheld that tax. In affirming the Tax Court decision, the Appellate Division held that Mary transferred the entire residence to the trust, even though she shared equal ownership of the home with Walter prior to the transfer.

The lower court's action raises a number of questions that require consideration by the Supreme Court:

What is the nature of a tenancy by the entirety?

Does tenancy by the entirety ownership continue despite the transfer of property to a trust?

Is a transfer of spousal entirety property to a trust, in which the spouses retain interests and give contingent interests to a third party, treated as a transfer for New Jersey inheritance tax purposes?

It is critically important that these questions be answered, and that practitioners be provided with clear guidance on how spousal transfers to a trust will be treated under the inheritance tax laws. Until the issuance of the Appellate Division decision, practitioners relied on a clear understanding that the transfer of property to a trust ended any tenancy by the entirety, and countless clients were so advised. The Appellate Division decision upends this understanding, and challenges the basic tenets underlying a majority of trusts into which spousal property has been transferred.

The Appellate Division opinion, like the Tax Court decision it affirmed, was selected for publication. Therefore, it constitutes binding precedent. See R. 1:36-3. Selection for publication means that the Committee on Opinions has determined that the opinion complies with the guidelines set forth in R. 1:36-2(d), which include whether the opinion "determines a new and important question of law, ... changes, reverses, seriously

questions or criticizes the soundness of an established principle of law, or ... is of continuing public interest and importance.”

The NJSBA submits that the Appellate Division does reverse an established principle of law, but does so through incorrectly applied legal principles. If left to stand, the decision will affect countless numbers of established trusts and significantly alter crucial decisions made in analyzing estate planning options and transferring property to a trust. For these reasons, the NJSBA believes it is pertinent for the Supreme Court to consider the matter and settle the questions raised by the Appellate Division decision.

As *amicus curiae*, the New Jersey State Bar Association (NJSBA) urges the Court to grant certification and reverse the Appellate Division decision.

PROCEDURAL HISTORY AND STATEMENT OF FACTS

The NJSBA shall rely upon the Procedural History and Statement of Facts as presented by the parties.

LEGAL ARGUMENT

I. THE APPELLATE DIVISION RULING MAKES A SIGNIFICANT CHANGE TO EXISTING PROPERTY AND INHERITANCE TAX LAW

A. The Appellate Division Ruling

In affirming the Tax Court's decision to assess an inheritance tax against a surviving spouse's estate of 100 percent of the value of property transferred to a trust held as tenants by the entirety, the Appellate Division opinion stands for the proposition that such property can be subject to a tax on 200 percent of the property - 100 percent upon one spouse's death and 100 percent upon the surviving spouse's death. The NJSBA contends that such a result is unintended, and will confound taxpayers and their advisors far into the future.

The Appellate Division begins its analysis with a summary of the nature and history of tenancy by the entirety in New Jersey. The court writes: "A tenancy by the entirety is a creature of the common law" and it is 'based on the legal concept that husband and wife are one.' Mueller v. Mueller, 95 N.J. Super. 244, 247 (App. Div. 1967)." Estate of Van Riper v. Director, Div. of Taxation, 456 N.J. Super. 314, 321 (App. Div. 2018).

The decision continues: "Estates by the entirety have no moieties. Each spouse holds the entirety and each spouse receives 'per tout et non per my.'" Id. In a footnote, the court explains that "[a] 'moiety' is a half. The phrase 'per tout et non per my'

means '[b]y the whole, and not by the half.'" Id. (footnote 2) (citations omitted).

From that background, the Appellate Division concluded that Walter and Mary each transferred the entire property, not just their respective portions, to the trust that they created in 2007. "Thus, Walter and Mary together transferred the property to their niece and the transfer was 'made . . . or intended to take effect in possession or enjoyment at or after' they died. See N.J.S.A. 54:34-1(c)." Id.

Thus, the court writes that at the time of Mary's death, "the entirety of the estate passed to the niece." Id. at 322. Confirming its analysis, the court writes: "Walter's death did not alter the nature of Mary's interest in the property when it was transferred to the trust. She held an undivided ownership interest in the home." Id. at 323. The court notes that "[t]here is no reason to value Walter and Mary's interests in the property as though they had agreed to partition the property when it was transferred to the trust." Id.

The Appellate Division decision squarely rejects the idea that Mary and Walter, being equal co-owners of the property, could each transfer only 50 percent of the property. According to the court, "This contention cannot ... be squared with the general principle that a husband and wife own property as tenants by the entirety." Id. at 325.

Reacting to the contention that treating both Mary and Walter as each transferring 100 percent of the property could create anomalous results, the court states:

...the result here is not 'nonsensical.' The Division has not imposed the inheritance transfer tax upon both estates. It has imposed the tax only upon Mary's ... Since Mary died after Walter, the full value of the property was includable in her estate for tax purposes.

Id.

Concededly, the focus here is on Mary because the Division asserts tax against her estate. However, the unavoidable implication of the Opinion is that Walter also transferred 100 percent of the property to the trust.¹ He, too, was a tenant "by the entirety" when the trust was created. Thus, the logical extension of the Opinion is that his estate could be taxed on 100 percent of the property as well.

B. The Appellate Division analysis is inconsistent with New Jersey property law

The Petitioner points out in her Petition for Certification that the transfer of entirety property to an irrevocable trust necessarily severs the tenancy by the entirety. That is what occurred when Walter and Mary created the trust. Thus, although Walter and Mary may not have formally "...agreed to partition the property when it was transferred to the trust..." (Id. at 323), a

¹At oral argument before the Appellate Division, the Director informed the Court that any attempt to collect tax from Walter's estate is now barred by the applicable statute of limitations.

partition is exactly what happened by operation of law when they conveyed ownership to a third party. See Nappe v. Nappe, 20 N.J. 337 (1956).

It is a basic tenet of property law that holding property in joint tenancy requires the four "unities" of time, title, interest and possession and to create an entireties interest requires a fifth unity, marriage. Additionally, the commonly understood definition of tenancy by the entirety is a type of joint ownership of property where property is owned by more than one person at a time. See "Four Unities," Black's Law Dictionary (2nd Edition online); Celentano, 13 N.J. Prac., Real Estate Law and Practice § 5.5, 5.13 (3d ed.).

By conveying the property to the trust, the "entireties" interest is terminated. In some states, statutes permit spouses to convey real estate to a trust without losing the benefits of tenancy-by-entirety ownership.² New Jersey has not enacted such a statute. Therefore, under New Jersey law, the tenancy by the entirety could not remain in effect after the transfer into the trust. Allowing this opinion to remain unchecked, however, contradicts this notion and leaves significant ambiguity in the

² See, e.g., Md. Est. & Tr. Law §14-113; Va. Code §55-20; 12 Del. C. §3334; 765 Ill. Cons. Stat. §1005-1c; Ind. Code §30-4-3-35; Mo. Rev. Stat. §456.950; N.C. Gen. Stat. §39-13.7; Tenn. Code. Ann. § 35-15-510; Wyo. Stat. Ann. §4-10-402(c)-(e).

law that the residence remained an entireties interest, even after Walter passed.

Upon the creation and funding of the trust, both Mary and Walter ceased being joint tenant owners of the residence and became beneficiaries of the trust. The creation of the trust permanently and fundamentally altered their legal rights and interests. As beneficiaries of an irrevocable trust, Walter and Mary had the right to enforce the terms of the trust and to insist that the trustee act with loyalty, impartiality and prudence. See N.J.S.A. 3B:31-54 to -70. They were entitled to information about the administration of the trust. N.J.S.A. 3B:31-67. However, they were no longer owners of the home. Their rights and interests arose only from the terms of the trust agreement. N.J.S.A. 3B:31-54.

When the trust came into existence, the Van Ripers' niece, Marita Kresge, also became a beneficiary, with enforceable legal rights. New Jersey's Uniform Trust Code defines the term "beneficiary" to include any person "who has any present or future interest, vested or contingent." N.J.S.A. 3B:31-3. Kresge, as a remainder beneficiary, held a future interest. The duties of a trustee extend to remainder beneficiaries as well as those entitled to the current benefits of trust assets.

The options available to a trustee in carrying out the trustee's duties to the beneficiaries would be limited under the Appellate Division decision, however. For example, the opinion

notes that the trust agreement permitted the trustee, acting alone, to sell the home. Estate of Van Riper, supra, 456 N.J. Super. at 317. This is a common power given to trustees in a trust agreement, yet it would be unenforceable if the home remained in a tenancy by the entirety, as contemplated under the opinion, since action by both spouses is necessary to convey real estate owned as tenancy by the entirety. N.J.S.A. 3B:28-3.

The NJSBA submits that these consequences could not have been what the Legislature intended. The NJSBA therefore urges the Court to grant certification and reverse the Appellate Division decision.

C. The Appellate Division ruling departs from New Jersey inheritance tax law regarding the taxation of transfers creating future interests

Although this case does not involve the Estate of Walter Van Riper, an understanding of the proper tax treatment at the time of his death assists in analyzing the operation of the inheritance tax statutes in this case. Walter, like Mary, signed the trust agreement and the Deed transferring ownership of the home to the trust. In doing so, he irrevocably transferred his interest in the residence to the trust, giving valuable rights to Mary and retaining similar rights for himself during his lifetime. More important, he created an enforceable remainder interest in his niece, Kresge.

When Walter died, his estate fell squarely within the scope of N.J.S.A. 54:34-1(a), the statute that the Director employs against Mary's estate in this case. He had made a transfer, and had retained the right to use the property for his lifetime. Yet, it was impossible to know at Walter's death how much Kresge would receive from the trust, or whether she would, in fact, survive Mary and receive anything.

The inheritance tax law recognizes that future interests in trusts create contingencies that may affect what assets, if any, pass to beneficiaries who are liable for inheritance tax. N.J.S.A. 54:36-3 provides for taxation of those interests when the beneficiary receives the property rather than when the transfer is made. To facilitate the prompt closing of estates, N.J.S.A. 54:36-6 authorizes the Director to enter into an agreement with the executor or trustee "for the purpose of compounding such taxes upon such terms as may be deemed equitable and expedient." This procedure is commonly referred to as the "compromise tax." The Division of Taxation has published guidelines to be used in computing offers of compromise. Guide for the Computation of the Compromise Tax (Revised Edition 2012), available at state.nj.us/treasury/taxation/pdf/CompromiseInheritanceTaxGuide.pdf (last visited Dec. 7, 2018).

The Appellate Division mentions the fact that Walter's estate filed an inheritance tax return and that the Division did not

assess a tax. Estate of Van Riper, supra, 456 N.J. Super. at 323. However, the opinion ignores the undisputed fact that the Division was given an opportunity to assess compromise tax on Walter's irrevocable transfer to the niece and either missed it or agreed that the value was zero. Just because the Division may have erred in its handling of Walter's estate should not give it an opportunity to have a second chance, as here, to tax the residence at Mary's death.

Notwithstanding this well-established body of law, the Appellate Division rejected the notion that a transfer occurred on Walter's passing.³ Id. at 327. Rather, it held: "Together, [Walter and Mary] made a transfer intended to take effect at or upon Walter or Mary's death, whichever was the last to occur." Id. (emphasis added).

The notion that the inheritance tax law applies to transfers by couples rather than by individuals is inaccurate. The statute refers to a transfer by "a resident of this State," or by a "decedent." N.J.S.A. 54:34-1a and -1b. The inheritance tax form (Form IT-R), allows for the name of just one decedent - there is no joint return. The inheritance tax law does not tax transfers by couples, but rather taxes transfers by individuals, whether married or not.

³ At oral argument before the Appellate Division, the Director argued that no taxable transfer occurred at the time of Walter's death.

A separate statute would be necessary to impose a tax on Mary's estate. Under current law, it is inappropriate to subject Walter's transfer to tax at Mary's death; there is simply no statutory support.

In contrast, the inheritance tax law of Pennsylvania allows the estates of married couples to elect whether a trust should be subject to tax in the estate of the first spouse to die or to tax the estate of the surviving spouse. Specifically, Pennsylvania's statutes allow for an election for exemption from tax "[i]n the case of a transfer of property for the sole use of the transferor's surviving spouse." 72 P.S. § 9113. In that case, the tax is "deemed to [create] transfers subject to tax by the surviving spouse ... at the death of the surviving spouse." Id. In order to impose a tax on a taxable transfer at the death of the survivor, another statute was needed to create a transfer by a non-transferor (e.g., an estate inclusionary statute). 72 P.S. § 9107(d).

Absent similar statutory authority, the proper action in this case was for the Division to impose a compromise tax on the first estate based upon actuarial interests, not tax the second estate on the full value of 100 percent of the property.

For these reasons, the NJSBA urges the Court to grant certification and reverse the Appellate Division decision.

II. THE APPELLATE DIVISION DECISION CREATES UNCERTAINTY IN THE LAW AND THREATENS WELL-ESTABLISHED ESTATE PLANNING TECHNIQUES AND FORMS OF OWNERSHIP

The Appellate Division's decision has far-reaching implications. It leaves intact the Tax Court's reported decision holding that Mary Van Riper's estate is subject to inheritance tax on the entire value of a residence transferred to a trust even though she never owned the entire residence. In other words, it imposes tax based on Mary's enjoyment of the trust property, without regard to whether she ever owned and transferred the property. The court's disregard of the transfer requirement as a prerequisite to inheritance taxation calls into question many commonly used estate planning strategies, and undermines the underlying premise, relied upon in good faith, of established trusts to which property owned as tenancy by the entirety has been transferred.

A bypass trust, or credit shelter, often used in estate planning for married couples, illustrates the uncertainty created by the Appellate Division decision. The will of one spouse (Spouse A) creates a trust giving Spouse B the right to income during Spouse B's lifetime. Upon Spouse B's death, the trust ends and the assets pass to a remainder beneficiary or beneficiaries. Suppose for example, that the couple has no children and upon Spouse B's death, the trust assets pass to Spouse A's brother. Siblings are

class C beneficiaries for inheritance tax purposes. Under well-settled law, the trust assets are not subject to inheritance tax in Spouse B's estate because Spouse B never owned them and did not transfer them to the trust. If the transfer requirement is disregarded, however, Spouse B's estate pays tax on assets that Spouse B never owned and never transferred. As is noted above, the NJSBA posits that there is a mechanism embodied in N.J.S.A. 54:36-6 to impose a tax in this situation through the "compromise tax," but not as the Appellate Division opinion suggests, a tax on 100 percent of the assets transferred to the trust in the first place.

A non-traditional family situation illustrates additional issues raised by the Appellate Division's unique analysis of tenancy by the entirety. Harry and Sally decide to transfer real estate, jointly owned by them as tenants by the entirety, to Harry's granddaughter Julie. Julie, however, is not Sally's granddaughter; she was born of Harry's prior marriage. Thus, Julie is a Class A beneficiary (granddaughter) as it relates to Harry, but is a Class D beneficiary (step-granddaughter) as related to Sally. See Hopkins v. Neeld, 41 N.J. Super. 345 (App. Div. 1956). If the Appellate Division decision is left to stand, when Harry and Sally turn over the property to Julie, there will be confusion

about the proper inheritance tax treatment if they die within three years after the transfer.⁴

Prior to the lower court decisions in this matter, the inheritance tax treatment was fairly straightforward. Harry has transferred his 50 percent interest to his granddaughter in a nontaxable transfer, while Sally has transferred her 50 percent interest to a Class D beneficiary. Therefore, Sally's transfer is subject to inheritance tax, calculated based on the value of her 50 percent interest.

The Appellate Division's decision, however, compels a different result. Sally has not transferred a 50 percent interest in the property - she has transferred the "entire" property (100 percent) to Julie and has died within three years, resulting in the imposition of inheritance tax on 100 percent of the value of the real estate. (Under the Appellate Division's analysis, Harry has also transferred the entire property to Julie, but Harry's transfer is exempt because Julie is his granddaughter).

Imagine instead that Harry and Sally decide to transfer the same jointly owned real estate to Harry's nephew, who is a Class D beneficiary, as it relates to both Harry and Sally. As in the previous example, Harry and Sally both die within three years after the transfer. The question again is: What inheritance tax is due?

⁴Property transferred within three years before death is presumed to be a transfer in contemplation of death, triggering inheritance tax under N.J.S.A. 54:34-1c.

The Appellate Division's decision compels the conclusion that Harry's estate is liable for tax on 100 percent of the value of the property, while Sally's estate is also liable for tax on 100 percent of the property value. By transferring property held as tenants by the entirety, Harry and Sally have subjected themselves to tax on 200 percent of the property's value, an unprecedented and, the NJSBA submits, unintended result.

Harry and Sally could, of course, if properly advised, avoid this harsh result by transferring the property out of tenancy by the entirety ownership before making the gift. Sound public policy would suggest, however, that they should not be required to take that extra step in order to avoid a confiscatory tax. In any event, the need for that extra step is a perilous trap for the unwary.

As these examples illustrate, the Appellate Division's decision inserts confusion and uncertainty into the planning process for spouses who own property jointly. Any transfer of property that may be subject to inheritance tax runs the risk of double taxation. The transfer need not be directly to a Class C or Class D beneficiary. As noted earlier, any transfer to a trust may create contingent interests that trigger an inheritance tax obligation.

Tenancy by the entirety is an extremely common form of ownership between New Jersey spouses and is favored by the law. A deed of real estate to married persons creates a tenancy by the

entirety unless another form of ownership is specified. N.J.S.A. 46:3-17.2. Real estate owned as tenants by the entirety enjoys protection from the claims of creditors. See Newman v. Chase, 70 N.J. 254 (1976); Jimenez v. Jimenez, 454 N.J. Super. 432 (App. Div. 2018).

The Appellate Division decision, however, creates a distinct disadvantage of tenancy by the entirety ownership: the risk that a transfer will generate an unexpected tax bill that could have been avoided by choosing a different form of ownership, despite the fact that nothing in the inheritance tax statutes or regulations, or in case law, compels such a result. This will inevitably create confusion and uncertainty in the estate planning process, and leave attorneys and their clients without a clear understanding of the ultimate tax treatment of property placed in a trust.

For these reasons, the NJSBA urges the Court to grant certification and reverse the Appellate Division decision, returning certainty and understanding to the estate planning process.

CONCLUSION

Because the Appellate Division decision makes a significant change to existing property and inheritance tax law, creating uncertainty and threatening well-established estate planning techniques and forms of ownership utilized frequently by New Jersey residents, the NJSBA urges the Court to grant certification and reverse the decision.

Respectfully submitted,

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Dated: 12/13/18

