

Transfer Tax Management – Q&A
Overview of Taxes to Consider

Question 1: I am a New Jersey resident. What transfer taxes should I consider?

Answer: In addition to the federal gift, estate and generation-skipping transfer taxes, New Jersey imposes estate and inheritance taxes.

Question 2: What is a gift tax?

Answer: The United States Government imposes a tax on gifts that you make during your life. If you give more than \$12,000.00 per year to any one individual, you will pay a tax equal to 45% (2007-2009) of the value of the gift. Although you may avoid paying the tax by filing a Form 709 gift tax return and using a part of your \$1,000,000.00 lifetime exemption, this will reduce your available estate-tax exclusion by an equal amount.

Question 3: Are there any exceptions to the gift tax?

Answer: Yes. Payments of qualified tuition and medical costs directly to the provider are not subject to the annual and lifetime exclusions and do not reduce your estate-tax exclusion.

Question 4: I want to make annual gifts of \$12,000.00 into a trust for my children. Will these gifts qualify for the annual exclusion?

Answer: Not unless your children receive written notice of the right to withdraw the \$12,000.00 within a reasonable time. Gifts in trust qualify for the annual exclusion only if the person receiving the gift, or his personal representative, has the right to withdraw the gift from the trust within a reasonable time (30-40 days) after the gift is deposited into the trust. Otherwise, you may use your \$1,000,000.00 lifetime exclusion to cover the gifts.

Question 5: How may I use the gift-tax exclusion to reduce estate tax?

Answer: There are several different techniques available, but they all involve leveraging the exclusion in some way. As a simple example, let's assume that you own shares in a small start-up company. The fair market value of each share is \$1.00. You intend to make an initial public offering (IPO) within 2 years. The potential return on investment is substantial. Immediately following the IPO, the shares are expected to trade at \$10.00. If you transfer 12,000 shares into a trust for each one of your children and give them the limited right to withdraw the shares of an equal value in money, you will not pay any gift tax. If the value of the shares increases as expected, each child's trust will have principal of \$120,000.00. If you had retained the shares and transferred them to the children through your Last Will, the \$120,000.00 per trust would be included in your taxable estate, but with a properly-drafted trust the value of the property held in trust would not

be included in your taxable estate. Granted, you would not have access to the funds, but the tax benefit may be worth relinquishing control over a share of your net worth.

Question 6: What is the generation-skipping transfer tax?

Answer: It is a second tax imposed on transfers to grandchildren and other “skip persons.” It is in addition to any other applicable transfer tax.

Question 7: What is the estate tax?

Answer: It is a tax on the value of what you own at death. When you die, the United States government imposes a tax on the fair market value of everything you own or control for your own benefit. Your taxable estate includes interests in real property, securities, personal property, cash, accounts, retirement funds, life insurance death benefit, etc. The exclusion for the period 2007-2008 is \$2,000,000.00. In 2009, the exclusion is scheduled to be \$3.5 million. Unless Congress and the President agree, there will be no estate tax in 2010. The exclusion is scheduled to decrease to \$1,000,000.00 in 2011.

Question 8: What is the rate of estate tax?

Answer: From now through 2009 amounts in excess of the exclusion are taxed at 45%. In 2011 and thereafter the tax rate will be 55%. After 2010, the value of your estate above one million dollars will be taxed at 55%.

Question 9: In the answer to Question 7 you have written that life insurance proceeds are included in my taxable estate. I heard that proceeds are not taxable. Which is it?

Answer: Both. The beneficiary of your policy will not have to pay income tax on the death benefit, but your estate will have to pay estate tax on the death benefit if you are both the owner and insured. One way to remove the value of the proceeds from your taxable estate is by transferring the policy to another owner such as an Irrevocable Life Insurance Trust (ILIT) or by having the trust purchase a policy insuring your life. Since the trust is the owner, the proceeds will not be taxed in your estate.

Question 10: Will the value of my retirement accounts be included in my estate?

Answer: Yes. The value of retirement funds will be included in the value of your taxable estate. Your beneficiary will have to pay tax on his required minimum distributions, but he will be entitled to a deduction for estate taxes paid.

Question 11: My wife is beneficiary of my life insurance and retirement funds. We own our home together and she is my sole residuary devisee in my Last Will. In other words, my wife gets everything I own when I die. Will she have to pay tax?

Answer: No. The United States government allows an unlimited marital deduction against the estate tax. However, unless you plan to use your estate-tax exclusion, you will lose it. Whatever your wife owns at the time of her death in excess of her personal exclusion will be taxed. She does not get to use your exclusion. You may avoid this result by: (1) creating a by-pass, credit-shelter trust in your will or (2) having an ILIT own the life insurance policy.

Question 12: Does New Jersey have an estate tax?

Yes: New Jersey's exclusion is \$675,000.00, and the rates range from 3% up to 10% and beyond depending on the value of the estate

Question 13: What is the inheritance tax?

Answer: New Jersey imposes a tax on transfers at death to siblings and more distantly related persons as well as unrelated persons. The tax rate ranges from 11% to 16%. The first \$25,000.00 going to a sibling is exempt. There is a general exemption of \$500 to all others. There is an unlimited charitable exemption. Life Insurance proceeds are exempt from the tax.

Question 14: I want to leave \$50,000.00 to each of my four nieces. In addition to my home and vacation/rental property, I have a \$500,000.00 IRA, a \$1,000,000.00 life insurance policy, and an \$850,000.00 brokerage account. How should I leave money to my nieces?

Answer: First, name each of them a 5% beneficiary of the life insurance policy; this will avoid the inheritance tax. You might also consider an ILIT to remove the proceeds from your estate that will be subject to New Jersey and United States estate taxes and to protect the money from the creditors and predators of your nieces.

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