

**Town Topics, August 18, 2004 Legal Forum:
"New Jersey Has Increased its 'Death Tax'"
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Everyone has heard of the Federal estate tax, sometimes referred to as the “death tax,” but did you know that New Jersey also has an estate tax? And, did you also know that the New Jersey estate tax has recently been changed to prevent a reduction in that tax which would otherwise have occurred as a result of the 2001 reductions in the Federal estate tax?

The Background: Federal tax law changes made in 2001 call for a gradual increase in the Federal estate tax exemption equivalent (the amount which each individual can pass to his/her heirs without incurring Federal estate tax). In 2001 the Federal exemption equivalent was \$675,000. Today, the exemption equivalent is \$1.5 million, remaining at that level through 2005. It then increases to \$2 million in 2006, 2007 and 2008, and to \$3.5 million in 2009. The Federal estate tax is eliminated in 2010, but then returns in 2011 with an exemption equivalent of \$1.0 million.

The N.J. estate tax, just like the Federal estate tax, is a “death tax” based upon the value of the deceased individual’s estate. It should not be confused with the N.J. inheritance tax which is another “death tax” but is based upon the relationship between the deceased individual and the beneficiary.

Prior to July 1, 2002, if there was no Federal estate tax due, then there would also be no N.J. estate tax. However, if an estate owed a Federal estate tax, then a portion of the Federal estate tax liability would be paid to New Jersey in the form of the N.J. estate tax and the balance would be paid to the Federal government. The N.J. estate tax did not increase the estate’s death tax liability, but rather, resulted in a “sharing” of the Federal estate tax between the Federal government and New Jersey.

The Change: As a result of the gradually increasing Federal estate tax exemption equivalent, New Jersey was facing potential losses in revenue, since there would be no N.J. estate tax until estates exceeded the increased Federal exemption equivalent. To avoid this loss of revenue, New Jersey amended its estate tax law to provide that the N.J. estate tax will be calculated based upon the Federal estate tax as it existed in 2001 (when the Federal exemption equivalent was \$675,000).

The Impact: This change in the N.J. estate tax particularly impacts married couples whose estate tax planning includes Wills incorporating so-called “credit shelter trusts” also referred to as A“by-pass trusts” (i.e., a trust funded with the full amount of the Federal exemption equivalent available to the first spouse to die). If such a trust is funded with an amount greater than \$675,000, there will be an immediate N.J. estate tax, whereas prior to the change, no N.J. estate tax was due. In short, where previously taking full advantage of the Federal exemption upon the death of the first spouse to die resulted in no Federal or state estate tax liability, now doing

so results in an immediate N.J. estate tax which could range between \$64,400 (2004-2005) and \$229,200 (2009). In light of the changes, both in the Federal and New Jersey estate taxes, it is important to revisit existing estate plans and reexamine existing Wills and Trusts. Failing to do so could result in an unplanned tax bite.