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Beware, New Jersey estate tax threshold is low

IT'S YOUR BUSINESS

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Q: We are starting to think about what happens to our estate when we pass on. What are some of the important considerations regarding federal and New Jersey state estate taxes?

We all know the old saying that there are only two things in life you cannot avoid: death and taxes. While we cannot avoid death, with careful planning estate taxes can be reduced and sometimes avoided completely. If the value of your estate is less than \$2 million and you pass in 2006, you are exempt from federal estate taxes.

Pay close attention to what falls into your estate, as \$2 million can add up quicker than you think. Your estate includes the value of your retirement plan, savings, investments, homes, cars, art collection and the often overlooked life insurance policies. Go over the limit and the tax bite can be brutal. In 2006, the maximum federal estate tax rate is a whopping 46 percent.

If the value of your estate is less than \$675,000 and you pass in 2006, you are exempt from New Jersey state estate taxes.

Clearly, exceeding New Jersey's \$675,000 threshold is even easier than the \$2 million federal threshold. Go over the limit and the tax bite would be in addition to any federal estate taxes. In 2006, the maximum New Jersey estate tax rate is 16 percent.

Fortunately, both the federal and New Jersey state estate tax laws include a marital deduction that permits the spouse that passes to transfer their entire estate to the remaining spouse, free of taxes — no matter the size of the estate. On the surface this seems like an easy solution, yet foregoing either your \$675,000 New Jersey state or \$2 million federal exemption could create an even larger tax burden for future beneficiaries when the remaining spouse passes.

Unfortunately, the remaining spouse is not permitted to combine their former spouse's New Jersey state or federal exemptions with their own exemptions. One solution to this problem is the bypass trust. By utilizing a bypass trust each spouse can take advantage of his or her estate tax exemptions. The trust comes alive, as defined by the wills, when the first spouse passes. To maximize the tax benefits, the wills dictate the funding of the bypass trusts at the maximum amount permitted by the exemptions in that year. Although most trusts name the children as the beneficiaries, the remaining spouse can utilize the trust for reasonable living expenses.

Things could get ugly in 2011. The federal estate tax exemption remains at \$2 million in 2007 and 2008, increasing to \$3.5 million in 2009. In 2010, the federal estate tax is repealed — meaning there is no estate tax, although this could change by the time 2010 rolls around. In 2011, the exemption returns with a relatively modest amount, \$1 million. To add insult to injury, the maximum federal estate tax rate jumps to an exorbitant 55 percent.

Do not forget about your will. Even the best-laid plans can go awry. All this information is wonderful, but without a legal will that clearly defines your intentions and what person or entity is to execute them — it is as good as useless. Recent statistics show a full 70 percent of U.S. adults do not have a valid will. Our lives are not static; the birth of children and grandchildren, marriages and divorces and the passing of loved ones are all part of our lives.

Making the effort to establish an estate plan with an expert can be one of the best investments of your life.

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