

# Money Matters

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## Skloff Financial Group: Question of the Month By Aaron Skloff

**Q: What are the new federal and state estate and gift tax laws?**

**A: The federal estate tax and gift tax exemption limits have been temporarily set at \$5 million each, for 2011 and 2012.** Amounts above that are subject to a federal estate or gift tax rate of 35%. The federal estate exemption amount is indexed for inflation from 2010, but does not start until 2012. In 2013, the federal estate tax exemption drops to \$1 million as the federal estate tax rate jumps to 55%.

**In addition to federal taxes, a number of states (including New Jersey), assess estate or inheritance taxes on assets below \$5 million.** New Jersey is one of the most abusive states in the country, with a mere \$675,000 state estate tax exemption and startling high 16% maximum state estate tax rate.

Let's look at an example where Logan has \$5 million in assets and his wife Madison has \$5 million in assets. If Logan passes away and Madison inherits \$5 million in assets, Madison will have a total of \$10 million in assets. If Madison passes away with \$10 million in assets, her estate will be exempt from federal estate taxes.

**Unfortunately, states like New Jersey still want their pound of flesh in the form of state estate taxes.** Although Logan can leave his full \$5 million to his spouse Madison free of state estate taxes due to an unlimited spousal exemption, Madison's estate will only have a \$675,000 state estate tax exemption. New Jersey's abusive tax code and lack of "portability" would subject the \$9.325 million balance to its state estate tax.

**One powerful tool to mitigate federal and state estate taxes is the Credit Shelter Trust (CST).** The CST, sometimes called a bypass trust allows each spouse to take advantage of his or her full federal or state 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 CST at the maximum amount permitted by the exemptions in that year.

**Fortunately, the new (and temporary) federal gift tax law allows each person to make tax free gifts up to \$5 million.** With the exception of Tennessee and Connecticut, no other state imposes gift taxes. But, with states in financial dire straits it will not be long before they implement more draconian tax laws. Gifting provides great opportunities to reduce the size of your estate and likely avoid future tax increases. Unfortunately, some assets such as: ownership in closely held businesses, 401(k)s, IRAs, and residences present obstacles to gifting.

**Another powerful tool to mitigate federal and state estate taxes is the Irrevocable Life Insurance Trust (ILIT).** While the beneficiaries of life insurance policies are not subject to taxation, the owner's estate could be – as life insurance is added to the estate's value. An estate that would normally be exempt from both federal and state estate taxes could become subject to both when life insurance proceeds are included.

With the ILIT, the trust is the beneficiary of the life insurance proceeds, not your estate. Once the ILIT is established, the trust can purchase life insurance policy on your behalf, with the trust stipulating who will receive the assets and under what conditions.

**Action Steps: Work closely with your Financial Advisor to eliminate or mitigate taxes and maximize your wealth.**

Note. Aaron Skloff, Accredited Investment Fiduciary (AIF), Chartered Financial Analyst (CFA), Master of Business Administration (MBA) is CEO of Skloff Financial Group, a Registered Investment Advisory firm based in Berkeley Heights. He can be contacted at [www.skloff.com](http://www.skloff.com) or 908-464-3060.