Estate Planning: Answers To Some Common Questions

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WHY HAVE A WILL?

At some point in life each of us recognizes our own mortality. If we have family, friends and property, we normally want to preserve our property for our family and friends, and to direct specific property or specific amounts of property to specific persons. Even those of us with little or no property will want to designate a guardian for minor children.

To put it in a different perspective, the things which you worked a lifetime to acquire or save can be taxed, administered and distributed according to the very general statutory plan of the state where you are domiciled at the time of death. Or you can create a specific plan to minimize taxes and to provide for the persons you care about.

As the federal government has reduced its taxation of decedents' estates, by raising the exemption level, many states have chosen the opposite route, occupying the revenue source vacated by IRS. State death taxes have become relatively more important, and the differences between death tax laws of different states are large. Persons who relocate, or who purchase real estate in another state, should be alert to state death tax issues and the need to review existing wills.

ELEMENTS OF A WILL

We're not sure what a "simple" will is. The general idea is "Everything to my spouse; but if no spouse, then everything to my children." Unfortunately, it's rarely quite that simple. Here are what we see as common elements of a will. Some are essential; all are at least helpful:

1. Statement of Domicile: This is usually not essential, but it may be helpful if you divide your time between New Jersey and Florida, and wish to pay death taxes only in one state.
2. Identification of Family Members: Usually we include this to make the will more personalized. But it also helps to defeat persons claiming to be illegitimate "children." It also settles the status of adopted persons, or stepchildren who are to be treated as children. DNA testing, in vitro fertilization, and domestic partnerships all affect the definition of "family."
3. Tangible Personal Property: Families fight about the furniture more often than they fight about money. The household and personal effects are unique, and they are a link between generations, between the living and the dead. You may wish to decide who gets a particular piece of jewelry. New Jersey permits the will to reference a separate list of tangibles, which may be revised from time to time. If you don't make such a list you should at least provide a mechanism for a fair division of such property.
4. General Bequests: A bequest of $500 to each grandchild is a general bequest.
5. Specific Bequests: A bequest of the seashore house is a specific bequest. A bequest of 100 shares of GM is also a specific bequest.

6. Residue: It is essential to provide for disposition of the residuary estate. The residue is what is left over after the tangible, general and specific bequests. This is where we say "Everything to my spouse; but if no spouse, then everything to my children." If you leave it to grandmother, who is 90 years of age, you should consider an alternate beneficiary if she should not survive. If there are minor children, you should probably include trust provisions.

7. Minors and Incompetents: We think it is prudent to provide for management of assets left to minors or incompetents. Death may occur years after the will is written, and by that time spouse may be senile, or a child may have died, so that the child's share passes to grandchildren who are minors. Absent such a provision, it will be managed by the courts, which is expensive and inconvenient.

8. Early Termination: If the share of the minor or incompetent is only a few dollars, or if a trust for a minor or incompetent turns out to be too small to justify the cost of trust administration, the executor or trustee should have discretion to put it in a bank account or turn it over to a family member.

9. Tax Clause: An essential clause. Who pays the tax on the bequest of $5,000 to nephew John? Does it come out of John's share, or out of the residue?

10. Fiduciary: Who will be the executor and trustee? A family member? Several family members? A bank? A combination? What if one of the individuals dies?

11. Fiduciary Powers: The statutory authority of executors and trustees varies from state to state. Therefore we include the powers which we think a

fiduciary should have. We assume that you trust the judgment of your fiduciary and that these powers should be broad.

12. Guardian: If you have minor children, you will want to name a guardian for them, should both parents be deceased. This is often a difficult decision.

13. Informal Settlement: It is faster and less expensive to have the beneficiaries approve the management and distribution of the estate, than to seek court approval. We encourage it. However, if there are minors or incompetents, or a dissatisfied beneficiary, then the matter may very well have to be approved in court.

14. Revocation Clause: Any will should revoke all prior wills. (An amendment to a will is a codicil, and is usually limited to one or two specific changes.)

15. Self-Proving Form: A "self-proving" will is one which will be accepted for probate without the need for the witnesses to appear. (Sometimes witnesses die or cannot be found.) The form requires that the testator and the two witnesses sign their names a second time, and that a notary attest to all three signatures. This makes signing a will more complicated, but we recommend it.

Many of these clauses will be found even in "simple" wills. Complex wills also contain such clauses, plus trust provisions and elaborate tax provisions. The difference between simple and complex is one of degree.

Whatever the type of will, it must be coordinated with the title to your property, and with contractual provisions of life insurance and pension plans. This is discussed in the next section.

PROBATE PROPERTY AND NON-PROBATE PROPERTY

Probate property is controlled by your will. Non- probate property is not controlled by your will. Therefore, unless you coordinate the ownership of your property with the provisions of your will, your will may not work the way you intended.

Joint property is the most common form of non-probate property. Normally it will pass to the surviving joint owner, regardless of the terms of your will. Joint property can cause problems:

Example: Widow's will leaves her estate equally to her two children. But because of concerns about her own health, widow has placed her bank accounts in joint name with her daughter, who lives nearby. At widow's death, these accounts will normally go to daughter, giving her an unequal share. Daughter may refuse to share them, feeling that she earned them by living nearby and helping her mother. Distant son may choose to fight about it, in court or within the family. (Widow should have given daughter a power of attorney for use in case of illness.)

Life insurance is another common form of non-probate property. Proceeds are paid, according to contract, to the designated beneficiary, regardless of what your will says. Here again, problems can arise:

Example: Husband's will creates a "credit trust", to be funded with $3,500,000,[*] which will provide income to Wife, but which will not be subject to federal estate tax at her later death. This $3,500,000 in trust is also free of tax in Husband's estate because of the unified credit (or "exemption equivalent") against the federal estate tax. Thus this $3,500,000 is intended to pass to the children untaxed. However, Husband neglects to

[*] This figure has been increased, effective 1/1/09, from $2 million in 2008. Regardless of the figure, the concept remains the same. Present expectation is that the $3.5 million figure, and the estate tax, will be maintained by the new administration.

designate “my estate” as beneficiary of his life insurance and it remains payable to spouse. At his death, his assets consist of the $1.5 million residence in joint name, $2 million in securities in joint name, $2,000,000 life insurance payable to Wife, and miscellaneous tangible assets. All goes to Wife. Feeling insecure after loss of her spouse (the normal reaction), she refuses to disclaim any of the insurance, and the chance to put up to $3.5 million in trust is lost. At her later death, the unnecessary tax on the $2,000,000 (because Wife has $5.5 million and only $3.5 million exemption) will be at least $900,000 (45% IRS rate, state tax ignored).

We have seen and experienced situations like these. In these cases the time and money spent writing the will was wasted because property was not titled properly, or beneficiary designation was overlooked.

Other forms of non-probate property include pension, profit sharing and IRAs. Like life insurance, they will pass to a designated beneficiary. If there is none, they may be paid to spouse or to the estate of the decedent, depending upon the terms of the plan and local law. (Note: spouses have statutory rights in qualified retirement plans, and must consent to being omitted as beneficiary. Also, for income tax reasons it is normally preferable to designate individuals, rather than estates or trusts, as beneficiaries of retirement assets.)

Trusts are also non-probate property. Frequently trusts are substitutes for wills, so that the overall estate plan is followed. However, your taxable estate may include a trust created for your benefit by someone else (parent, spouse). In this case it is particularly important to coordinate your estate plan with the terms of the trust. We have also seen forgotten life insurance trusts, created by the decedent, at variance with his final estate plan.

Estate planning usually involves more than just writing a will. You must consider the nature of your property, its title, contractual provisions, the amount, and potential taxes. The time and money spent on your will may be wasted if you fail to consider these things.

DEATH TAXES

At the time of your death, the assets which you have accumulated during a lifetime of hard work are subject to tax by both the federal government, and the state government where you are domiciled. Any real estate will be subject to tax at its location.

I. Federal Estate Tax

A. In General:

The Federal Estate Tax (FET) applies to estates of $3.5 million or more in 2009.[*] The marginal rate of tax is 45% on amounts over $3.5 million.

The FET and the Federal Gift Tax (FGT) are "unified". That is, taxable lifetime gifts (gifts which exceed $13,000 per donee per year[*]) are aggregated with the taxable estate in order to calculate the tax.

There is a "unified credit"[*] which offsets the FET-FGT on the first $3.5 million[*] of taxable assets. This is why the tax is applicable only to estates which exceed $3.5 million.[*] (This unity began to break up after 2003, when the FET exemption equivalent rose above $1 million while the FGT figure remained stuck at $1,000,000.)

There was also a "credit for state death taxes", which ranged from 0.8% to 16%. This was really a revenue-sharing device whereby the federal government allowed the state government to claim a portion of the taxes. This credit was allowed only if the state in fact collected the amount. A state was and is also free to impose death taxes which exceed this credit. The 2001 act phased out this credit over four years, depriving those states which relied upon it for revenue. In 2005, this credit became zero. Some states reacted by re-enacting death taxes to regain this revenue. New Jersey has reacted by demanding an

[*] The 2001 tax act raised these figures. The figure increased to $3,500,000 in year 2009. The maximum rate was gradually lowered to 45% in 2007. The $13,000 figure is indexed to inflation.

estate tax based upon the state tax credit as it existed in 2001, that is, 100% of it and based upon a $675,000 exemption equivalent.

A "credit for prior transfers" may apply when a decedent has received a taxable inheritance within the 10 years prior to his or her own death.

Deductions are allowed for debts of the decedent, funeral and administration expenses, charitable bequests, and bequests to the decedent's spouse. State death taxes are now deductible; this deduction replaces the former credit for state death taxes.

B. Marital Deduction:

The most important deduction from the FET-FGT is the marital deduction. All amounts given to your spouse, either during lifetime or at death, are eligible for a 100% marital deduction. Thus, if you leave everything to your spouse, there will be no FET.

The marital deduction provides a strong incentive to give property to your spouse. However, there are situations, such as second marriages, where a decedent may want to provide for children as well as for spouse. Since 1982, it has been possible to obtain the marital deduction while preserving principal for children, through a "qualified terminable interest property" (Q-TIP) trust. Such a trust provides income to spouse for life. During spouse's life, principal may or may not be made available to spouse, but only after spouse has died may the principal be used by anyone else.

One consequence of the Q-TIP election is that the trust principal will be included in spouse's later estate for FET purposes. Provision should be made to pay the resulting death taxes from the trust, rather than from spouse's own assets.

There are many other forms of trust which will qualify for the marital deduction. A trust which ends upon the remarriage of the spouse will not qualify.

To summarize, the marital deduction can be obtained, at a minimum, by giving spouse income for life. At the maximum, property would be given to spouse outright, without restriction.

If your spouse is not a United States citizen, no marital deduction will be allowed, except for property placed in a "qualified domestic trust". The FET will be imposed when principal is distributed from this trust. The surviving spouse may create such a trust if the decedent failed to do so. Apparently Congress feared that non-citizen spouses would take property out of reach of the IRS.

C. Credit Trust (or By-Pass Trust):

Please note that you and your spouse could each leave $3.5 million (2009 figure) to your children free of tax (because of your unified credits). That is $7,000,000 in total from the two estates. But if you leave everything to your spouse, then at the time of your spouse's death, your spouse can only leave $3.5 million in total to your children free of tax. The additional tax to your children (on the $3.5 million you didn't leave to your children) is at least $1,575,000 (45% IRS rate, New Jersey tax ignored).

How can you provide for your spouse and also save the taxes on the second $3.5 million (or the excess over the first $3.5 million)? One common solution to this problem is a trust (called variously a "credit", "shelter", "by-pass", "non-marital", "residuary" and "B" trust) which pays income to spouse, and at spouse's death, principal to children. (A bank account or a share of stock is principal; the interest or divided is income.) The first decedent creates this trust, funding it with up to $3.5 million (the maximum amount shielded from tax in the first estate--2009 figure). This trust will not be included in the spouse's later estate. Thus the up to $3.5 million in the credit trust of the first decedent, plus up to $3.5 million in the spouse's later estate, passes free of tax to the children.

(Couples having less than $7 million but more than $3.5 million, should divide assets roughly in half. If there are retirement assets payable to spouse, as is normally desired, ignore those for purpose of this division; divide all other financial and real estate assets.)

The credit trust is a useful compromise between providing for spouse and minimizing taxes for children. The maximum benefit which may be given to spouse, without causing the trust to be included in spouse's later estate, is:

1. all of the income
2. principal, if needed for support
3. the greater of $5,000 or 5% of the principal, each year, on demand
4. power to direct by will who will receive the principal (unless the trust principal has been funded by disclaimer of the surviving spouse), so long as it is not paid to spouse's estate, the spouse's creditors, or the creditors of spouse's estate.

If item 3 is selected, the amount of $5,000 or 5% of the trust principal will be included in the spouse's later estate. (An independent or adverse trustee may be given <u>discretion</u> to be even more generous to spouse, but spouse cannot have the <u>right</u> to principal except for "health, maintenance, support and education.")

Please note that the credit trust provides no tax benefit for decedent or for the surviving spouse. The tax savings occurs at the death of the surviving spouse, for the benefit of children. Meanwhile, the surviving spouse must tolerate the inconvenience of having limited rights to principal. This means, for instance, that unless the trust language directs otherwise, the trustee will invest not to maximize income (which spouse may desire) nor to maximize growth (which children may desire), but to provide a "reasonable" income and a reasonable prospect for growth of principal. Whether this inconvenience is

viewed as large or small will depend on the spouse's other assets, and the relationship between spouse and children.

The secret of the credit trust is that, for federal estate tax purposes, it is treated as passing directly from the first decedent to the children, whereas in fact the trust does not pass to the children until spouse dies, which may be many years later. During those years the principal of the trust may have grown much larger than $3,500,000, and spouse will have benefited from the income, and perhaps from principal as well.

Please note that the credit trust cannot be fully funded unless the decedent had at least $3.5 million in separate name. Joint property will not fund this trust. Life insurance and pension will not fund this trust unless payable to the trust or to the estate. Failure to properly title assets can upset the estate plan. (Disclaimers can sometimes correct such problems.) Full funding may not be necessary if the couple has less than $7 million and it can be assumed that the surviving spouse will never have more than $3.5 million. (But note that New Jersey imposes its estate tax on estates exceeding $675,000, so you will want to do a similar analysis of New Jersey estate tax, using $675,000 instead of $3.5 million.)

Please note that if the amount of the credit trust is tied to the credit, or exemption equivalent, then as this figure has increased (as was provided by the 2001 act) the trust amount increases while the amount going to the surviving spouse decreases. This can be mitigated by (1) dividing assets equally between spouses during lifetimes, (2) placing a cap on the trust amount, or a floor on the spouse's share, or (3) reversing priority between the credit trust and the surviving spouse, so that nothing goes to the trust unless the surviving spouse disclaims it.

II. Generation Skipping Tax (GST)

A typical generation skipping trust is one in which generation 1 establishes a trust to pay income to generation 2 and generation 3, with principal remainder to generation 4. The FET would apply only at the deaths of generation 1 and 4. The GST is designed to apply to generations 2 and 3.

The GST is a tax which should be avoided, if possible. Its rate is 45%, the maximum FET rate. There is a $3.5 million exemption, applicable at the generation 1 level, which may be continued by trust as long as a trust can last (until recently, the life of a person now living plus 21 years; but New Jersey and some other states have recently lifted this limit).

In planning, we try to avoid the GST by using the exemption, or by subjecting property to the FET, which may be lower. If a trust may become subject to the GST, we try to divide it into two trusts, one of which is GST exempt and one of which is not. It is often difficult to predict whether a trust will become subject to the GST, or to know how and where to allocate the GST exemption.

The GST applies to gifts to grandchildren. If the gift exceeds $13,000 in one year, you must use up part of your $3.5 million exemption.

III. Federal Excise Tax on Excess Pension

This 15% tax on “excess” (large) pensions was repealed by the 1997 act. Nevertheless, the combined impact of the federal income tax and the federal estate tax can approach 65% - even after the “relief” of this repealer. State income tax and state death taxes consume an additional share.

IV. New Jersey Death Taxes

A. Transfer Inheritance Tax:

In contrast to the FET, which is based upon the decedent's total assets, the New Jersey Transfer Inheritance Tax is based upon the amount inherited by each beneficiary, and the "class" of the beneficiary.

In the late 1980's New Jersey enacted a full marital deduction, and it has reduced taxes upon lineal decedents and lineal ancestors (class A beneficiaries) to zero. Thus for many persons this tax is no longer applicable.

Class C beneficiaries (brothers, sisters, sons-in-law, daughters-in-law) are subject to tax of 11% to 16% on amounts over $25,000.

Class D beneficiaries (everyone else) are subject to tax of 15% to 16% on amounts over $499.

Most charities (Class E beneficiaries) are exempt.

Life insurance policies paid directly to any person are exempt. If paid to your estate, the policy may be taxed, according to the identity of the ultimate beneficiary.

B. New Jersey Estate Tax:

New Jersey also has an estate tax, which was originally designed to pick up the amount by which the federal credit for state death taxes exceeds the Inheritance Tax. If it were not paid to New Jersey, it would have to be paid to IRS.

Until 1988, the Inheritance Tax was rarely less than the federal credit. With the revisions to the Inheritance Tax, the Estate Tax became much more important. Until 2002 it applied only in cases where there was a federal estate tax - that is, taxable estate of more than $675,000 after-marital deduction.[***] The federal estate tax exemption has now

[***] This is the year 2001 figure for the federal estate tax exemption; it increased to $3,500,000 in year 2009.

increased well beyond $675,000, but New Jersey still imposes its estate tax using the 2001 federal figure.

With the phase-out by the federal credit for state death taxes, begun in 2002 and completed by 2005, the New Jersey estate tax might have been eliminated as the credit no longer exists for calculation of the federal estate tax. New Jersey and other states have revised their death taxes to recapture this lost revenue. (And some states have eliminated death taxes, making it attractive to retire, for example, to Florida, rather than remain in New Jersey.) New Jersey's legislation freezes its estate tax at 2001 levels; the New Jersey estate tax will be calculated as if the federal exemption equivalent were still $675,000 and the state death tax credit had not been phased out. The consequence of this is that estates between $675,000 and $3.5 million, after the marital deduction, will be exempt from federal estate tax but subject to New Jersey estate tax. Estates over $3.5 million will pay combined federal and New Jersey estate taxes which exceed the maximum federal estate tax rate (before the credit or deduction for state death taxes), which is 45% in 2009.

Planning which employs a by-pass trust is now complicated by the need to decide which exemption equivalent should be used -- the federal one or New Jersey's? Those using the federal level will pay a New Jersey estate tax at the death of the spouse who is first to die. Those using the New Jersey level will avoid any estate tax at the first death, but may pay more federal estate tax at the second death. But perhaps the increased federal exemption equivalent will protect the second estate. Without a crystal ball, this can be a difficult decision.

2008 - Marginal Rates

	NJ	IRS (before state tax deduction)	Total (marginal IRS deducting marginal New Jersey, plus marginal NJ)	Total 2001 Rate
to $675,000	0	0	0`	0
to $727,147	37.0	0	37.0	37
to $900,000	4.8	0	4.8	39
to $1,000,000	5.6	0	5.6	39
to $1,100,000	5.6	0	5.6	41
to $1,250,000	6.4	0	6.4	41
to $1,500,000	6.4	0	6.4	43
to $1,600,000	6.4	0	6.4	45
to $2,000,000	7.2	0	7.2	45
to $2,100,000	7.2	45	48.96	49
to $2,500,000	8.0	45	49.4	49
to $2,600,000	8.0	45	49.4	50
to $3,000,000	8.8	45	49.84	53
to $3,100,000	8.8	45	49.84	55
to $3,600,000	9.6	45	50.28	55
to $4,100,000	10.4	45	50.72	55
to $5,100,000	11.2	45	51.16	55
to $6,100,000	12.0	45	51.6	55
to $7,100,000	12.8	45	52.04	55
to $8,100,000	13.6	45	52.48	55
to $9,100,000	14.4	45	52.92	55
to $10,100,000	15.2	45	53.36	55
Over	16.0	45	53.8	55

NJ average rate

675,000 to 727,174	37%
675,000 to 3,500,000	8.11%

New Jersey’s estate tax rate and exemption level are unchanged from 2001. Federal rate relief is largely a myth because the IRS posted rate reduction is largely offset by replacement of the credit for state death taxes with a deduction for those taxes. However, most estates do benefit from the increased IRS exemption level (unified credit), which either renders them non-taxable, or reduces the total tax burden.

Some examples

$ millions		2001	2008
1.0	IRS	92,050	0
	NJ	33,200	33,200
	Total	125,250	33,200
2.0	IRS	460,650	0
	NJ	99,600	99,600
	Total	560,250	99,600
3.0	IRS	888,250	368,100
	NJ	182,000	182,000
	Total	1,070,250	550,100
5.0	IRS	1,778,650	1,173,780
	NJ	391,600	391,600
	Total	2,170,250	1,565,380
10.0	IRS	3,852,650	3,119,580
	NJ	1,067,600	1,067,600
	Total	4,920,250	4,187,180

TAX PLANNING PROBLEMS

Estate planning used to be easier than it has become in recent years. Although the implementation might be complex, there were three basic rules:

1. Both spouses should utilize the federal "unified credit" or "exemption equivalent." That meant not leaving all to the surviving spouse, and utilizing a by-pass trust to get the exemption equivalent in the first of the two estates. First dollars went to the by-pass trust.
2. Use the marital deduction to defer any estate tax to the time of the second death. Dollars in excess of the exemption equivalent go to spouse.
3. Dollars in excess of those needed for financial security (if any) should be given away.

1. The rising federal exemption equivalent calls Rule 1 into question. A couple with $3.5 million in 2008 requires a by-pass trust to assure that there will be no federal estate tax (two $2 million exemption equivalents can protect $4 million if all is suitably arranged). But in 2009 the exemption equivalent is $3.5 million, which will allow this couple to tear up their 2008 wills and make "simple" wills, leaving all to spouse, free of trust. The whole $3.5 million can pass to children through the second estate free of federal estate tax in 2009.

If this couple did not want to rewrite their wills as the exemption equivalent changed, in 2008 they could have made "disclaimer" wills or "QTIP" trusts. Under the disclaimer will, the by-pass trust is in stand-by status; nothing gets into it unless the surviving spouse "disclaims" (refuses) property left to him/her by the deceased spouse. The will says "all to spouse," but also provides a by-pass trust to receive any disclaimed property. The

surviving spouse will know the year of death, the amount of the exemption equivalent and other tax laws, and the total amount of the decedent's property and the surviving spouse's property. With that information (not known at the time the will is signed), the surviving spouse is in a good position to make the best decision for minimizing taxes and administrative burdens. (However, loss of spouse or ill health may present emotional barriers to making the best decision.) The other alternative, the QTIP trust, can be written so as to qualify either as a by-pass trust, or as a marital deduction trust, or partly each, in the discretion of the executor, who will also have all of that information needed to make the best decision. (However, the assets will be in a trust, which may not be desired by the surviving spouse if the trust is not necessary for saving taxes.)

2. The rising federal exemption equivalent, together with the economic decline, has rendered Rule 3 irrelevant for most people. Even those with more than $3.5 million are often paralyzed by economic uncertainty.

3. Many persons have wills with by-pass trusts based upon Rule 1: first dollars go to fill up the by-pass trust. The "fill up" is tied to the federal exemption equivalent, which has risen. So under the will of this potential decedent, with each increase in the exemption equivalent, more dollars are scheduled to be allocated to the by-pass trust (Rule 1) and fewer dollars are left for spouse (Rule 2). If each spouse has half of the combined assets, this should pose no problem, as the surviving spouse will have half and the by-pass trust will have half. But if the decedent had the bulk of the assets, those assets may all wind up in the by-pass trust, and the surviving spouse may have relatively little funds which are free of trust. Because of the increased $3.5 million exemption, this problem can be disastrous for couples with old wills (marital and non-marital shares) with unbalanced assets.

4. All of the above is based upon the federal estate tax, but now we must also consider the New Jersey estate tax as a separate but related problem. Which exemption equivalent, federal or New Jersey, should we focus upon at the first death? Do we fill up the by-pass trust to the lower New Jersey level (avoiding any estate taxes in the first estate but producing a larger second estate, and potentially higher estate taxes then). Or do we fill up to the higher federal level, voluntarily paying some New Jersey estate tax at the first death, so as to avoid the risk of higher federal and New Jersey estate taxes in the second estate? This sounds like a straightforward comparison calculation, if we assume that the federal exemption equivalent is no longer rising. Because estate tax rates are relatively flat (now 45% for the federal rate, plus the New Jersey rate of 4.8% to 16%, less the effect of deduction of the New Jersey tax), and because the federal exemption equivalent has risen to a generous level, serious consideration should be given to using the $675,000 New Jersey level so as to produce zero estate tax at the first death, preserving all assets for the benefit of the surviving spouse.

The disclaimer will and the QTIP trust are both suited for creating the flexibility to allow the surviving spouse or executor to consider and choose the best of these alternatives. However, some clients have also made choices now; some have capped the amount of the by-pass trust at $675,000 or even less, choosing to fund it only to the extent that they judge to be needed to minimize taxes. Some have determined that, absent total repeal, they will always face stiff federal and New Jersey estate taxes, so they will take the full federal exemption equivalent and pay some New Jersey tax at the time of the first death. The surviving spouse will not lack for financial security; overall lowest tax is their primary goal. (They also assume that there will be no repeal of the federal estate tax as has now been confirmed.)

In summary, the old rules are no longer easy to apply because of (1) increased federal exemption equivalent; (2) different and lower New Jersey exemption equivalent; (3) possibility of changes to the federal estate tax, other than repeal; (4) possibility of further moves by states to preserve revenue or to capture revenue left by the federal withdrawal, and (5) variations in state responses. Since few of us can predict when we will die, we cannot know what economic circumstances will apply, to our own estate, or to our spouse's estate. The possibility of further legislative change also clouds the outlook. (The new administration has stated that the $3.5 million federal exemption will remain in place, as will the federal estate tax itself. History suggests that further tinkering is likely, however.)

FIDUCIARIES

In making a will, you must choose a fiduciary. At a minimum, you will need to appoint an executor. You may also need to appoint a trustee or a guardian. Executors, trustees and guardians are all fiduciaries, appointed by you to perform certain functions after your death.

Your executor is responsible for settling your estate. This means gathering together your assets, paying your debts and death taxes, and making distribution to your beneficiaries. In the meantime your fiduciary must keep property insured, decide what should be sold, invest cash, obtain appraisals and file income tax returns. This process usually takes one or two years. (In some states, such as Florida, the executor is called the “personal representative.”)

A trustee’s functions are similar to those of an executor, but instead of performing for a year or two, the trustee will manage assets over a long term, perhaps a lifetime or longer. Usually the trustee is managing cash and securities, but it may also control real estate or a family business.

The guardian is appointed to care for minor children, or for an incompetent. The guardian may be guardian of the person, guardian of the property, or both.

Usually the executor and the trustee will be the same persons. This is because the talents required are the same, and because property management is a continuous process.

The guardian need not be the executor too. In fact the care of children and the management of money may require two different types of person. A guardian is an individual who will provide a home, care and affection for children. Testamentary guardians do not normally control much property; the trustee is given that job. By contrast, someone

applying to become guardian for an elderly person will usually be given responsibility for the person and the person's property.

Should your executor and trustee be an individual, or a bank trust department or a branch of your broker, mutual fund or life insurance company? Compensation should not be a decisive issue, because individuals are entitled to be paid, just as corporate trustees are. Consider some of the following strengths and weaknesses:

Individuals may have an intimate knowledge of the family or of the family business. This may help to make a more informed decision, or it can result in emotion clouding the decision making process. Individuals may be more flexible or risk tolerant. Again, this can be good or bad. It may be wise to hang onto that real estate investment, or it may be best to unload it.

Individuals are mortal; they may not be around to finish to job. Individuals have their own busy lives to lead; do they have time for your business? Does this individual have record keeping skills, investment skills? Will the individual be fair to all beneficiaries? Will the beneficiaries accept this individual's decisions?

Corporate trust departments do not die, but they do experience personnel changes and budget cutbacks. They are excellent record keepers and they rarely miss deadlines. They are disinterested arbiters between competing beneficiaries. They do not steal. Should they make a mistake, they are able to pay for it. Trust assets are segregated, so that if the bank fails your property is not lost.

A frequent criticism of banks, as expressed by clients, is investment performance. Will they "dump" the family business? Why don't they invest more aggressively? The law encourages fiduciaries, corporate or individual, to invest conservatively, to preserve

capital, to avoid risks. Thus they invest in “widows and orphans” stocks.[*] And that is appropriate, because it is usually widows and orphans that trusts are designed to take care of. While an entrepreneur may be able to create wealth faster than a trust department, after that entrepreneur has died, the trust department, rather than spouse or child, may be the better choice to manage the funds.

A possible criticism of brokerage firms is that they are good with securities, but may have little interest in real estate or the family business. This may be a weakness of any fiduciary; real estate and businesses involve greater uncertainty and risk, and thus take more time.

Many clients decide to use both an individual and a corporate fiduciary, thereby using the strengths of each. Many clients also request a mechanism for removal and replacement of a corporate fiduciary, feeling that this solves possible problems of inattention in large institutions.

If you employ a corporate fiduciary, you may wish to discuss fees in advance. While fees tend to be similar, there may be differences, particularly if more than one service is needed.

As a result of recent New Jersey legislation, attorneys-in-fact are now also classified as fiduciaries, required to “account” for their actions, and entitled to “reasonable” compensation. Apparently (the law could be clearer), they are now required to exercise their authority, whereas prior to this legislation it was believed that they need not do so. Of course, this assumes that the person is aware that he/she has been appointed as attorney-in-fact.

[*] We have a new “Prudent Investor” standard for fiduciary investment, intended to permit “total return” investing and greater risk-reward in a portion of the overall portfolio. Whether this will cause fiduciaries to be less defensive remains to be seen. The issue applies to all fiduciaries, corporate or individual.

AVOIDING PROBATE

Several popular books have been written about "avoiding probate". The probate process varies somewhat from state to state. In New Jersey it is not a traumatic experience. (In other states, such as Florida, it can indeed be expensive and time consuming, which is why revocable trusts are popular in Florida, but less so here.) Probate, literally, is "proving" the will, filing it with the Surrogate. What you may object to is: (1) the will becomes a public document, and (2) the particulars (dollars and cents) of estate administration may also become public documents. You may also be unwilling to endure the 10 day wait after death until your executor is authorized to act.

The will is indeed a public document, if anyone cares to look at it. Apart from the beneficiaries and immediate family (usually the same group) people rarely do. The alternative to a will, the trust document, may also become a public document should any beneficiary or would-be beneficiary bring a court action.

The dollars and cents of estate administration need not become public documents if all beneficiaries are adults, competent, and satisfied with the administration of the estate. In such case they can approve the executor's account by signing their receipt and release. In New Jersey an executor is not required to automatically file an inventory of the estate. If there is a minor or incompetent beneficiary, the estate administration may need to be filed in and approved in court, but the same would be true for a trust. If there is a dissatisfied beneficiary, the money issues will become public information and subject to court proceedings regardless of whether a will or a trust is used.

The lifetime revocable trust may be a good idea for someone who is in poor health, or old enough to be concerned about poor health. Establishing and funding such a trust requires transfer of all securities, and other assets. The trustee begins to function and is

entitled to be paid (although in most cases the creator of the trust will choose to be trustee so long as he/she is able). In some cases the funding of the trust is postponed, and a power of attorney is given so that the attorney-in-fact can transfer the assets to the trust if and when the trust is needed. At death a “pour over” will throws into the trust any property which is not already there.

Joint property, pension and life insurance also avoid probate. Joint property passes to the surviving joint owner. Life insurance and pension pass to the contract beneficiary. Neither is “probate property” controlled by the will. And that is precisely the problem. Regardless of what your will says, this property is unaffected by your will (except for life insurance or pension payable to “my estate”, or for which there is no named beneficiary).

It is not unusual to find that a decedent’s will leaves everything equally to three children, but all of the decedent’s bank accounts are in joint name with the child who lived nearby. Unless this child agrees that this designation was only for convenience, this child will receive more than a one third share.

It is also not unusual for a decedent’s will to provide for a credit (or “by-pass”) trust of up to $3.5 million, which is intended to by-pass the taxable estate of the surviving spouse, and then for the executor to find that the trust cannot be fully funded because the decedent’s property was in joint name. (If this situation is caught immediately, it can sometimes be salvaged by use of a disclaimer, if the spouse is willing to disclaim.)

In summary, probate in New Jersey is normally not anything to be worried about. And non-probate property can sometimes ruin a good estate plan. Thus it is important that your estate plan consider both documents (will and/or trust) and the nature of and title to your property.

Federal and state death taxes will apply to property which you own and control, regardless of whether it is probate property or non-probate property. Avoiding probate does not avoid death taxes - unless you give the property away (and major gifts may also involve gift taxes).

Corporate fiduciaries may have different fees for administration of probate and non-probate property. Avoidance of fiduciary fees should not dictate the form of your estate plan, because they are less important than providing for your beneficiaries and minimizing death taxes. Fees should be discussed and understood; sometimes they can be negotiated if the normal fee schedule seems inappropriate.

There is one problem with probate which should be considered. It is the statutory rule that the letters of administration, which authorize the executor to act, cannot be issued until 10 days after death. This can cause problems in two situations. In one situation the decedent has substantial securities holdings and does not want his portfolio frozen for 10 days or more with no one authorized to buy or sell. In the other situation the decedent fears that a family member may object to the will. The 10 day period is intended to permit anyone to file a caveat (objection) to the will; that stops everything until a judge decides the issue, which can take months. By placing assets in a revocable trust during lifetime, one can assure that trust administration proceeds unless and until an objector is able to obtain the assistance of a court. The burden of changing the trust administration is thrown upon the objector. This can be a good reason for avoiding probate.

New Jersey imposes a lien against decedent’s property to assure the payment of inheritance and estate taxes. With its estate tax applying to estates exceeding $675,000, the lien is a common annoyance, depriving the surviving family members access to half of bank accounts, New Jersey securities, and proceeds from sale of real estate until all New

Jersey death taxes are paid, <u>and</u> the auditor agrees that they are paid. However, this lien does not apply to property in a revocable trust. So this is another argument in favor of a revocable trust.

LIVING TRUSTS (REVOCABLE TRUSTS)

Lifetime trusts are excellent documents in some circumstances, but some of the claims being made for them are inaccurate.

A lifetime revocable trust (which is what a living trust is) will not save any federal estate tax, any New Jersey inheritance tax, nor any New Jersey estate tax. None. Zero.

A living trust will avoid probate. In New Jersey, this is usually not important. (See Avoiding Probate section.) In Florida, this can be important because of the requirement to file an inventory, close court supervision, and high costs. It depends upon where you are domiciled.

A living trust is an excellent idea for someone unable or unwilling to manage his or her own money. The most common candidate is someone experiencing poor health, or old enough to worry about continued good health. The trust will provide lifetime management of assets; if health fails, the other trustee(s) will take over.

With the increasing volatility of the stock market, a living trust can assure that there is always someone able to act with regard to your securities; a successor trustee can take over immediately after your death. By contrast, New Jersey probate law prevents your executor from being appointed and being able to act until 10 days after death. Meanwhile, your securities and everything else are in limbo.

A living trust will cost you more money to set up than a will. There are two documents rather than one (will and trust). If the trust is "unfunded" you will need a third document; a power of attorney should funding be needed. (The reasons for making a revocable trust usually lead also to funding that trust; if you do not want to fund the trust, do you really need one?) If the trust is "funded," you will transfer title of assets to the trustee, which involves time and expense. The trustee of a funded trust has assets to manage and is

therefore entitled to be paid. However, you may be your own trustee as long as your health allows.

A living trust typically contains the same sort of post-death estate plan as would normally appear in a will. Added to that are provisions to take care of you, your money, and your family from now until your date of death. If you are still able to take care of these things yourself, you may wish to leave the trust unfunded and in stand-by status. Or you can fund it and act as sole trustee until ill health or death arrives. If ill health has already arrived, you will probably want to fund the trust and turn over day-to-day management to your co-trustee.

For income tax purposes, a revocable trust is ignored because you still have complete control over it (subject to limitations of health only). Some years ago, IRS required these trusts to have separate tax identification numbers, but at present such trusts use your own Social Security number. During your lifetime, the income, gains and losses of the trust are reported directly on your income tax return, as if no trust existed. At your death, the trust becomes a separate taxpayer with a separate tax identification number, just as your estate would be.

For title purposes, if you choose to fund your trust, title is placed in the name of the trustee, who may be you, or someone else, or both: “X and Y, trustees of the X Revocable Trust Dated 1/1/09.” You sign things “X, trustee.” Banks and stockbrokers may ask to see a copy of the trust. Title insurance and casualty/liability insurance for real estate need coverage riders to reflect that title is now in the trust. This can be confusing and annoying, which is why you may choose to leave such a trust unfunded unless and until you really need asset management. At that point you, or your attorney-in-fact using power of attorney, can transfer your property to the trustee. However, if the reason you chose a

revocable trust is to avoid the 10-day wait for probating your will or the New Jersey tax lien, logic suggests that you also “fund” the trust.

The 2002 change to the New Jersey estate tax has extended the lien for inheritance taxes to estate taxes (since IRS will not enforce collection for estates which are less than its tax threshold). The lien applies to New Jersey bank accounts and securities of New Jersey companies and institutions. The lien can be avoided by titling theses assets in a revocable trust. This has made revocable trusts more important and more common in New Jersey.

Again, these trusts are wonderful for someone who needs asset management. And revocable trusts do avoid probate and the estate tax lien, if that is important to your circumstances. But they don’t save any death taxes, and any other miraculous claims should be met with skepticism.

POWER OF ATTORNEY

The purpose of a power of attorney is to authorize someone else to act for you if you are not able to act for yourself. You may be away (on vacation or stationed abroad) or you may be ill. As you get older and can no longer take good health for granted, you may wish to give power of attorney to spouse or child.

Our form of power of attorney is very broad; we intend it to be able to cover almost any problem which may arise, from paying the bills to selling the house. Such authority should not be given unless you have complete trust in the attorney-in-fact (the person to whom you give power of attorney). We can change, add to, or delete from our form, to give or withhold power. But, no document can protect you from someone who is not trustworthy.

Our power of attorney is “durable,” which means that it remains effective if you become incompetent. Until the common law was changed by statute in New Jersey, incompetency revoked a power of attorney, which made it useless at precisely the time when it was needed most. Now, by statute, if a power of attorney contains the language “The validity of this instrument shall not be affected by the disability of the principal,” it is durable. (You, the person signing the power of attorney, are the principal.)

No one can guarantee you that all third parties will recognize and accept a power of attorney. It is not unusual for a bank or broker to want its own form signed. Recently, we were told by a local bank that it had a policy of refusing powers of attorney which are more than one year old. To date, we have been able to persuade third parties to accept our form, sometimes after argument. A 1991 statute assures banks that powers of attorney which contain a statutory reference authorize the common banking transactions listed in

that statute. Other institutions can rely upon the powers enumerated in the statute. We have incorporated this reference in our form.

For real estate transactions, the power of attorney must be recorded. Sometimes third persons request that it be recorded to make revocation less likely. Our power of attorney is in “recordable” form.

We recommend that you sign several copies of the power of attorney. If the only copy is being recorded, or if each bank demands the only copy, you would be inconvenienced.

You may revoke a power of attorney at any time by notifying the attorney-in-fact. This should be done by writing. We recommend that you retrieve and destroy all copies, if that is possible. If the power of attorney has been recorded, the revocation must also be recorded. Revocation is prospective only; it does not undo what has been done prior to revocation.

Death of the principal terminates the power of attorney. Authority then passes to the decedent’s executor.

Recent statutory amendments state that the attorney-in-fact is a fiduciary, bound to act in the interest of the principal. The attorney-in-fact is authorized to act, but is not clear whether he or she is required to act (although he or she may feel obligated to do so). We think he or she is obligated to do so. The attorney-in-fact may be required to “account” to the principal or the principal’s successor, such as a guardian or executor. The attorney-in-fact may be compensated under written agreement with the principal, or a court may award “reasonable” compensation. The attorney-in-fact may be removed only by the principal or by a court. The statute authorizes the attorney-in-fact to delegate his or her powers to others.

The attorney-in-fact has no implied authority to make gifts to anyone, even if that may be good estate planning. Any authority to make gifts must be contained in the power of attorney and must be explicit. Our standard form does not contain such authority for two reasons: first, few persons desire to give such authority; and second, it creates a "general power of appointment" in the attorney-in-fact, so that if the attorney-in-fact dies, his estate is deemed to include the assets of the principal - and that can cause some undesired death tax problems.

It is critically important that the attorney-in-fact keep complete and detailed records of all receipts and expenditures. He must be able to explain to the principal what he has done. Should the principal die, the attorney-in-fact must be able to show the executor and beneficiaries what has been done. We recommend a separate bank account for all receipts and disbursements. Make copies of all checks received and bills paid, to back up the checkbook record.

In cases where the principal is ill and elderly, and a child acts as attorney-in-fact for a lengthy period, it may be wise to periodically present the account (the records) to the principal for written approval. This will reduce the exposure of the child to inquiries by others who may be suspicious or hostile. There will be fewer years, records and dollars to argue about. Approval by the principal releases the attorney-in-fact from liability to the principal, and from liability to the heirs of the principal.

Of course it is always possible for an attorney-in-fact to act in his or her own interest, rather than in the interest of the principal. If the principal is incompetent, there may be no one to object. Objection by the heirs, after the principal's death, may come too late. For that reason the power of attorney should be given only if you have complete trust in the attorney-in-fact.

ADVANCE HEALTH CARE DIRECTIVE
(Or Living Will) (Or Health Care Power of Attorney)

In 1991, New Jersey enacted a statute which provides for advance health care directives. This legislation and the advance health care directive is an outgrowth of the old "living will," the Karen Ann Quinlan case, an aging population, and medical technology. Many persons have a fear of living "too long" in a vegetative state, with resulting economic hardships on their families and loved ones. None of us wants to be comatose, or senile, or severely disabled by stroke, and an object of pity. But if we should reach that condition, then what?

The advance health care directive has two purposes. The first is to appoint someone else to make health care decisions for you, in the event that you cannot make such decisions for yourself. The second purpose is to give that person some guidance in making those decisions.

The easy part is accomplished by identifying the decision maker and providing specific authority to act. The difficult and controversial part is whether or not to grant authority to discontinue or to withhold medical treatment, and in providing guidance about when to do so. These are literally life and death issues.

Some believe that advance health care directives should be very detailed, describing specific medical conditions and medical procedures. We take the opposite view, inasmuch as it is very difficult for lawyers and other non-medical persons to foresee and understand all that may happen. Furthermore, medical procedures are constantly evolving. So we have chosen to describe desired goals, rather than the procedures to be used in reaching them.

Our experience is that individuals wish to be conscious, competent (not vegetative or advanced senile), and free of severe, chronic pain (agony). That is the goal. Pain relief in itself is usually desirable, but if there is no prospect of achieving the overall goal, then the decision maker is authorized to discontinue other treatment. There is specific direction to consider the cost of treatment.

If this philosophy is not your philosophy, our form can be modified to reflect your philosophy. We will need your help in expressing it.

Our form also goes into some of the nuts and bolts of providing health care. It gives authority to make contracts, to hire and fire, to commit funds.

Many of the things said about the financial power of attorney apply also to the health care power of attorney: It is revocable. It is durable. It authorizes; it does not command. There is authority for paying "reasonable" compensation to the attorney-in-fact (the decision maker). (Can authority to refuse medical treatment be delegated?)

It may be in your interest to provide your regular doctor with the advance health care directive and power of attorney, and to specifically ask whether it, or any decisions to decline or discontinue treatment, will create philosophical differences with him (or her) or with the hospital to which he (or she) refers.

The same discussion should be had with your health care decision maker. You should not name someone whose philosophy is very different from your own.

This document is not foolproof. Should you be in an automobile accident, the emergency squad won't know that it exists, and will probably be too busy to ask. Should you have a stroke, no one can tell if it is a "big" or "little" stroke or whether you will recover, until after the event; therefore you will receive medical treatment to stabilize you, and only

later will you learn your prognosis. Nevertheless, it is better than nothing, and should at least allow you to decline surgery, radiation and chemotherapy if it appears to be futile.

GUARDIANSHIP

A guardian is a person appointed to act on behalf of and for the benefit of a minor or incapacitated person (formerly an "incompetent person"). Minors are legally unable to act for themselves, and incompetents are mentally and sometimes physically unable to do so. An adult is presumed to be competent until a court determines incompetency--even if it is obvious to everyone that the adult is not competent. Unless the adult is willing to cooperate, an incompetency proceeding may be the only way to obtain necessary control over the adult or his property.

Guardians are court-appointed; however, a parent may appoint a guardian for minor children by will. Appointment of a guardian through a court proceeding takes time and considerable expense, including doctors' examinations of adults. Persons who are now competent, but fear that age or illness may cause incompetence, should consider having a power of attorney and/or a revocable trust. For similar reasons, parents should name guardians for children by will, which is less expensive and quicker than a court proceeding.

In the absence of will, revocable trust, or power of attorney to determine the identity of the guardian (or attorney in fact, or trustee), the "next of kin" may apply to be appointed guardian. Where there is no spouse, there may be more than one person with equal degree of kinship. Moreover, the next of kin who applies for appointment may not be the desired choice. A properly drawn will, trust, or power of attorney can provide greater certainty that the right person is in charge.

Guardianship may extend to both the person of the ward and the property of the ward. A person who has executed a power of attorney or a revocable trust may not need a guardian of his property, but may still require a guardian of his person to manage his care. Similarly, children may have little property, or parents may have provided trusts for them,

leaving the guardian responsible primarily for their care. Bequests to minors will be held by the county Surrogate if no trustee has been named. Nevertheless, guardianship will often involve the property of the ward, even if the amounts are modest, or if application must be made to expend funds held by the Surrogate or trustees. And in some circumstances, particularly with adults, management of property may be the primary responsibility of the guardian.

Guardianship of minor children typically means providing a home and surrogate parenting. Guardianship of adults typically means providing physical care and money management for an elderly person, either by taking that person into one’s home, or by arranging for institutional care. Guardianship for the developmentally disabled may involve home or institutional care.

Even if the ward has some financial resources, the guardian may be required to find and manage benefits and treatment available from public sources, such as social security, medicare, medicaid, health providers, and social services. If the financial resources of the ward are limited or non-existent, as if often the case, then such benefits are critically important. Dealing with the providers and managing the paperwork is no easy task.

A guardian, like an executor, trustee, or attorney-in-fact, is a fiduciary. Fiduciaries are required to act in the best interests of the person that they represent. A guardian must act in good faith for the best interests of the ward. As guardian of the person, the guardian must be prepared to demonstrate that the ward is receiving adequate and appropriate physical, emotional and educational care. As guardian of property, the guardian must be prepared to show that the property has been prudently managed, invested, and expended. A guardian who fails to act in the best interests of the ward, or who betrays his trust, will be

removed and replaced. Such a person may also be subject to financial or even criminal penalties.

As is the case with other fiduciaries, the guardian of property must keep complete and detailed financial records. Periodically the guardian will render an accounting to show that he has managed the property as a prudent person would manage his own property. Such accounting may be demanded at any time by the court, or by a family member interested in the welfare of the ward. Should the ward die, his executor or beneficiary may demand such an accounting.

To protect against misappropriation of funds, a guardian will normally be required to post bond. The annual premium for the bond is typically $5 per $1,000 of assets belonging to the ward. This is an annual charge, which can be quite burdensome. Where the guardian is appointed by will, the bond can be waived by the will. There is authority for protective arrangements in lieu of bonding. Statute does not authorize waiver of bond for a court appointed guardian, although judicial waiver or reduction has been observed in some rare instances. Where bond is required, the bonding company may demand supervision or counter-signing of the guardian's accounts.

In summary, guardianship is a system for management of the person and property of minors and incompetents (including both the elderly and the developmentally disabled). As is to be expected when dealing with another person's care and property, caution and conservation is emphasized. Institutional procedures and controls result in time and money costs. Where the circumstances requiring guardianship can be foreseen, better alternatives exist for management of property, through trusts or power of attorney. The recent statutory framework of "advance heath care directives" (a combination of health care power of attorney and living will) now seems to offer an alternative to guardian of the

person as well. Nevertheless, for those unable to plan ahead for themselves, such as minors and the developmentally disabled, and those who fail to plan ahead, including many elderly and afflicted persons, guardianship provides a means for the management of their persons and their financial affairs.

Recent legislation authorizes “conservatorships” for persons requiring assistance but who are not incompetent. No conservator may be appointed except by consent of the adult, but the adult may not terminate conservatorship without court approval. Our experience is that if the adult is incompetent, it is too late for conservatorship, and if the adult is competent, a power of attorney or revocable trust will be preferable. An uncooperative adult who refuses power of attorney or revocable trust will also refuse conservatorship. We have been involved in only one conservatorship, for an adult of marginal ability who understood her inability to withstand bad influences, and her need for assistance.

INTESTACY LAWS

If you die without a will, you die "intestate." Each state has "intestacy" laws which determine who will receive the property of intestate decedents. New Jersey revised it's intestacy laws in 2004. In New Jersey, the general rules are now as follows:

A. If spouse survives, no children:

1. If no parents, all to spouse.

2. If parents, 25% to spouse but not less than $50,000 nor more than $200,000, then 75% to spouse and 25% to parents.

B. If spouse survives, also children:

1. If spouse is parent of all the children and spouse has no other children, all to spouse.

2. If spouse is not the parent of all the children or spouse has other children, 25% to spouse but not less than $50,000, nor more than $200,000, then 75% to spouse and 25% to children.

C. If children survive, no spouse: all to children, equally, with descendants of deceased children to take by representation.

D. If neither spouse nor children survive:

1. To parents, if any.

2. If no parents, then to descendants of parents (brothers, sisters, nieces, nephews, etc.) by representation.

3. If no descendants of parents, then to grandparents or descendants of grandparents.

4. If none of the above, to step-children or their descendants by representation.

5. If none of the above, to the State of New Jersey.

Please note that "non-probate" property is not controlled by these rules. Joint property will pass to the surviving joint owner. Life insurance and pension will go to the designated beneficiary.

Under the new rules “per stirpes” and “by representation” now have different definitions. By representation now means “per capita at each generation.” Example: Three children, two of them deceased leaving two and three children (grandchildren), respectively. Surviving child gets one-third and the five grandchildren (children of the deceased children) take equal parts of the two-thirds, or two-fifteenths each.

Please note that property passing to minors or incompetents will fall under the jurisdiction and control of the Surrogate Court and the Superior Court; application must be made to obtain and spend the funds. It is the responsibility of parents to support children until they become emancipated, so the Superior Court will not authorize use of the child’s funds without first being assured that the child’s need is one which exceeds the parent’s means. (A trust may be more generous to both child and parents.)

GUARDIAN FOR MINORS

If there is no surviving spouse, then one of “the heirs” of the decedent may be appointed as guardian of minor children, if the decedent has made no appointment. This leaves considerable uncertainty about who will step forward and who will be appointed. It is best to have a will which designates the guardian of your minor children. See the Guardianship section.

“TRADITIONAL” IRAs (and Pensions)

Pensions and IRAs are useful because they postpone income tax, allowing funds to grow faster, thereby producing a larger retirement fund (compared to after tax savings). (The Roth IRA involves after-tax saving with income-tax-free withdrawal. It and the education IRA are not discussed herein.) What follows here are income tax rules applicable to IRAs and pensions under section 401(a)(9). However, your pension or IRA may contain more restrictive rules, and your pension may provide no death benefit for anyone except your spouse. There is no substitute for reading your IRA or pension.

The longer that you can continue income tax deferral (assuming a positive investment return - an obvious problem lately), the more powerful the effects will be. But IRS wants its income tax, and imposes a “minimum distribution requirement” (MDR) so that you must withdraw the funds and pay income tax. The MDRs begin at the later of (1) actual retirement, and (2) April 1 of the year after the year in which you reach age 70½ .

Formerly, the MDR was determined by dividing your life expectancy into the number one. If your life expectancy was eight years, you would draw 12.5% in this calendar year, based on the 12/31 value of the preceding calendar year, and if you had named a death beneficiary (or beneficiaries) to receive whatever was left in your account at your death, then you could use that person’s life expectancy and your own, based upon last-to-die tables. Because the last to die life expectancy of two persons is longer than the life expectancy of one of those persons, this lowered the MDR, and lengthened the income tax deferral period.

In an unexpectedly generous move, IRS has adopted regulations, available for use in 2001 and after, establishing an MDR table to be used by everyone except an IRA owner who is married to someone who is more than 10 years younger. That person will continue

to use the old two-life tables, but everyone else will now use a single table, based upon the joint and survivor life expectancy of the distributee and another person ten years younger. Participants will determine their distribution period and MDR by referring to the table and locating their current age. Designated death beneficiaries will refer to beneficiary age in the year following participant's death to determine distribution period, and subtract one for each subsequent year. The one table greatly simplifies determination of MDR, and the table is generous as to life expectancy, allowing greater deferral.

IRS has also made it easier to determine beneficiary identity, to create separate accounts for separate beneficiaries, and to use trusts for IRAs. In general, beneficiaries and separate accounts may now be determined as late as 12/31 following the year of death, making it possible to disclaim, to divide accounts into separate shares, and to provide trust documentation. The old need to try to determine such matters by age 70-1/2, in order to fix MDR, no longer applies.

It is still important to designate individual death beneficiaries. Lack of a proper death beneficiary can cause loss of further income tax deferral at death. With certain exceptions, estates, trusts and charities lack life expectancies and naming them as death beneficiaries (or failing to choose a beneficiary) may cause the IRA to be taxed sooner than necessary.

Your spouse is the only person permitted to "rollover" your IRA or pension death benefit, turning it into your spouse's own IRA. The rollover allows spouse to name a new death beneficiary (or beneficiaries), perhaps your children. This extends tax deferral into another generation. Also, no estate tax is due until spouse dies, because of the marital deduction. (The new "non-spouse rollover" refers to moving a lump sum pension benefit into an "inherited" IRA, spreading out the tax over the life of the beneficiary, but not to the next generation.)

If your taxable estate is sufficiently large, federal estate taxes may be due on your IRA at your death, or if your spouse is beneficiary, at your spouse's death. If a non-spouse death beneficiary must withdraw from the IRA to pay estate taxes, that will generate income tax, requiring more withdrawal, generating more income tax. (Combined federal income and estate taxes can approach 65%, and more if state taxes are considered.) But if estate taxes can be paid from other funds, your child may now take the IRA over his or her life expectancy, which will typically be another 25 years. If you assume that the IRA will earn 6% on average, it will actually grow until the child's life expectancy falls to 16 years or less (as late as age 82 according to the new table), producing an MDR over 6%.

If you die before the IRA is in pay status--age 70½ or actual retirement--it must be withdrawn within five years or over the life expectancy of your death beneficiary. But your spouse can still roll it over.

IRAs are generally the last choice for funding a "credit" or "by-pass" trust. First, your spouse will be unable to rollover, thus eliminating the chance for partial deferral over your children's lifetimes. Second, the amount directed to the credit trust eventually will be diminished by income taxes, so the estate tax benefit is less than the benefit of using assets which will not be reduced by income taxes. Third, the chances are that much of the IRA will have been withdrawn and paid to spouse before spouse dies. That means the IRA will not have by-passed spouse's estate, and will be subject to estate tax in spouse's estate. Paying the IRA to the trust works only if spouse dies early. Even then, rollover and payment to children is no longer possible. Thus, the IRA should be used for the by-pass trust only if you anticipate that the estate tax benefits will exceed the income tax drawbacks, and only if you lack sufficient other assets to fill the by-pass trust.

Roth IRA

In a Roth IRA you get no income tax deduction for the contribution, but investment earnings are not taxed upon withdrawal. With no income tax at stake, IRS does not require that you take MDR's during your lifetime. After your death, normal MDR rules apply.

All other things being equal (easy to assume, but rare in reality) a Roth IRA will produce more after-tax income for you than a traditional IRA. That is because you can put "more" into it; an after-tax dollar is worth more than a deferred tax dollar. "More" dollars saved at an earlier date translates into a greater after-tax amount at retirement, when income tax would otherwise apply in a traditional IRA. Also, you are not turning capital gains into ordinary income, as is the case with the traditional IRA.

Conversion from a traditional IRA to a Roth IRA is a highly complicated issue, involving prediction of future income tax rates and investment returns, and comparing effects of converting over more than one year. But we can say with confidence that converting a large amount while residing in New Jersey is very expensive because of New Jersey's 8.97% tax bracket on income over $500,000. Some states don't tax IRAs and some states have no income tax.

(Unfortunately, New Jersey has high death taxes, and high income taxes, not to mention real estate taxes and sales taxes, which goes a long way toward explaining why it is losing population.)

If you think your investments will rebound from the present downturn, then (all things being equal) now would be a good time to convert. Lower amount, lower income tax, later gains will be tax free. But you live in New Jersey now, so if you will be in Florida at a future time, all things are not equal and you must consider that state income tax difference.

Until the cap comes off in 1/1/10 (if present law remains in place), taxpayers with more than $100,000 adjusted gross income (joint return or single, same number) are not eligible for conversion to a Roth IRA.