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Focus on State Estate Taxes

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We were alerted by one of our blog readers last week to a *Wall Street Journal* editorial published on February 8 stating that, from an estate tax perspective, New Jersey is the worst state in which to die. The article explains that up to 54% of a New Jersey decedent's wealth could be lost to estate taxes in 2011 (New York decedents would lose 45.4%). While we disagree with some of the factual assertions set forth in the article (including that the state death tax deduction is new in 2011 – it is not and has been in place since 2005), we agree with the larger point that state estate taxes should be a significant concern for New Jersey (and New York) taxpayers.

With the federal estate tax exemption at $5 million per person in 2011 and 2012, the margin between the New Jersey exemption ($675,000) and the New York exemption ($1 million) has widened appreciably. The consequence is that for married taxpayers who want to take advantage of the first spouse to die's full federal exemption and pass $5 million to their beneficiaries (for example, to an exemption trust for the benefit of the surviving spouse and/or children), then without special planning, a New Jersey/New York estate tax of approximately $391,600 would be due. Parties must consider whether it is worthwhile to pay some state level estate tax in the first spouse to die's estate, especially in light of the fact that beginning in 2011, a married decedent's federal estate tax exemption is portable, meaning the surviving spouse can use the first spouse to die's unused estate tax exemption amount.

A number of variables factor into the decision, including: (1) the size of the surviving spouse's estate; (2) all appreciation of the assets owned in the exemption trust will pass free of federal and state estate taxes in the future; (3) the current law is in place for two years, and as a result, the federal exemption amount could be reduced and estate tax rates (currently 35%) could be increased; (4) the age of surviving spouse; and (5) future plans of the surviving spouse, who possibly could move to a state with no estate tax (ie, Florida).

All of these decisions lead to another point. Estate plans need to be drafted in a very flexible manner to enable different decisions to be made depending on each taxpayer's individual circumstances. It is not appropriate in this tax environment to have an inflexible plan.

Cole, Schotz, Meisel, Forman & Leonard, P.A.

Court Plaza North
25 Main Street
Hackensack, NJ 07601
Phone: (201) 489-3000

900 Third Avenue
16th Floor
New York, NY 10022
Phone: (212) 752-8000

500 Delaware Avenue
Suite 1410
Wilmington, DE 19801
Phone: (302) 652-3131

300 East Lombard Street Suite 2000
Baltimore, MD 21202
Phone: (410) 230-0660

301 Commerce Street
Suite 1700
Fort Worth, TX 76102
Phone: (817) 810-5250