

## Estate Planning & Elder Law

### N.J. Estate Planning for Same-Sex Couples

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When formulating an estate plan for a same-sex couple, an attorney must not only consider the federal tax regime, but must also give thought to New Jersey estate and inheritance taxes. Same-sex couples in New Jersey who have entered into a civil union may claim the unlimited marital deduction for New Jersey estate tax purposes, but not for federal estate tax purposes. Consequently, planning can be tricky.

New Jersey grants civil-union partners the same rights enjoyed by married heterosexual couples who are both citizens of the United States. For New Jersey inheritance tax purposes, a civil-union partner is a Class A beneficiary and no inheritance tax is imposed on a transfer to a civil-union partner. Generally, the children of a civil-union couple are also Class A beneficiaries. For New Jersey estate tax purposes, the marital deduction is available for transfers outright to a civil-

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union partner and transfers to a trust that would otherwise qualify for the marital deduction under the federal internal revenue code.

As mentioned, the federal Defense of Marriage Act defines "marriage" as the union between one man and one woman. 1 U.S.C. §7. Therefore, the federal government will not recognize same-sex marriages and the unlimited marital deduction for federal estate and gift taxes is unavailable to same-sex partners.

#### Couples with Children

A typical plan for a civil-union couple where both partners are citizens of the United States (assumed for the balance of this article) with children is similar to a heterosexual married couple with children. A straightforward, but generally inefficient tax plan for a couple with more than \$675,000 in joint assets would be to transfer all assets to the surviving civil-union partner at the first death, and transfer assets to their children at the death of the second partner. In this plan, due to the unlimited marital deduction, there would be no New Jersey estate tax when the first partner passes away. In an estate of \$3 million, at the second death, New Jersey estate tax would be due in the amount of

\$182,000.

A more tax efficient plan would be for the decedent civil-union partner to bequeath property with a value equal to the New Jersey applicable credit exemption — currently \$675,000 — to a Credit Shelter Trust for the benefit of the surviving civil union partner, and provide that at the survivor's death, the property be distributed to the decedent's children. The rest of the decedent's property would be transferred to the survivor, outright, or in a trust qualifying for the marital deduction (a QTIP type trust). At the second death, the balance of the estate would pass to the couple's children. Upon the decedent's death, there is no New Jersey inheritance tax and no estate tax on this type of plan.

This plan allows the civil-union couple to pay the least amount of inheritance and estate taxes, \$124,800, by taking advantage of both partners' applicable credit exemption of \$675,000, to result in a savings of \$57,200. These taxes could be decreased further if the couple, during their lifetimes, made gifts to their children and thereby removed some property from their estate, since New Jersey does not impose a gift tax. One partner may also consider setting up a credit-shelter type trust during his lifetime, with assets up to the federal applicable credit amount, which would benefit his civil-union partner and the children, taking advantage of the lack of gift tax in New Jersey and thereby further reducing New Jersey estate tax.

### Couples without Children

If a civil-union couple without children utilized the plan described above, the couple would pay more than necessary in New Jersey estate and inheritance tax. For a civil-union couple without children, the remainder beneficiaries will likely be Class C or Class D beneficiaries for inheritance tax purposes, and subject to inheritance tax rates of 11 to 16 percent (depending upon the class). The decedent's transfer of the life estate interest in the Credit Shelter Trust to the survivor is free from inheritance tax, but the transfer of the contingent remainder to Class C or Class D beneficiaries is subject to inheritance tax. The inheritance tax on the contingent remainder is due after the beneficiary receives the property, when the surviving civil union partner passes away. N.J.S.A. 54:36-5. If a civil-union couple transferred all assets to the surviving partner at the death of the first to pass away, and at the second death the entire estate was paid to nieces and nephews, outright, they would be subject to New Jersey estate and inheritance taxes of \$473,000 in the second estate.

If a trust is established for the surviving partner providing an income interest for life, the New Jersey Tax Commissioner can enter into an agreement with the executor to pay a compromise tax at the death of the first partner to pass away. There is no required method of calculation, but one method is to determine the tax on the present value of the remainder interest. If the executor of the estate and the Division of Taxation are unable to reach an agreement on the amount of the compromise tax, then the tax will be deferred until the death of

the surviving civil-union partner, and the executor will be required to post a bond to secure the payment of the tax. N.J.S.A. 54:36-6.

The following example will demonstrate a compromise tax calculation. For the purpose of the calculations, assume the decedent dies owning \$3 million worth of property, and the female survivor is 64 years old. Assume that at her death, the decedent funds a credit-shelter trust with \$675,000, and bequeaths \$2,325,000 to her surviving partner outright. The credit-shelter trust provides for mandatory income to the survivor, and at the survivor's death the assets in the trust transfer to nieces and nephews, who are Class D beneficiaries. Upon the survivor's death, the survivor bequeaths the \$2,325,000 worth of property to nieces and nephews outright. Based upon the life-estate tables as published by the New Jersey Department of the Treasury Division of Taxation, the executor would propose a compromise tax of \$11,475 in inheritance taxes on the decedent's transfer to the credit-shelter trust. At the death of the survivor, \$365,000 in inheritance taxes would be paid on the outright transfer to Class D beneficiaries. No additional New Jersey estate taxes would be paid. For this plan, New Jersey inheritance and estate taxes total \$376,475.

Assume instead that the decedent devises the entire \$3 million estate to a trust (the "Family Trust"), with a mandatory income interest for the survivor, and provides that upon the survivor's death the property is to be distributed to Class D beneficiaries. The executor proposes a compromise tax to fully and finally settle the inheritance

tax on the contingent remainder to the Class D beneficiaries when the first civil union partner passes away. The decedent's executor would not make an election to obtain the marital deduction for the Family Trust when the first civil union partner passes away. The result of this estate plan is \$182,000 in compromise inheritance taxes and estate taxes at the first death, and no N.J. inheritance or estate taxes owed at the second death, for total N.J. estate and inheritance taxes of \$182,000.

It may be possible for the executor to negotiate a compromise inheritance tax where a QTIP election over the amounts above the applicable credit exemption is made. With a QTIP election, the decedent's estate would not pay any estate taxes when the first partner passes away, only the compromise inheritance tax. The \$2,325,000 in the Family Trust would be includible in the survivor's estate for the purposes of the N.J. estate tax upon the survivor's death. The survivor's estate would use the survivor's applicable credit exemption for a further estate tax reduction. The result of this estate plan is a proposed compromise inheritance tax of \$51,000 at the first death and \$124,800 in estate taxes (assuming no change in the value of the QTIP trust) at the second death, for total N.J. inheritance and estate taxes of \$175,800.

As shown above, planning for couples with children and without children is somewhat different. While counterintuitive, it can be helpful to forego a marital deduction and fund a trust for the surviving civil-union partner, where the ultimate beneficiaries are Class C and Class D beneficiaries. ■