TAX AND TRUSTS & ESTATES UPDATE

October 2016

New Jersey Repeals Its Estate Tax; Inheritance Tax Remains (for now)

On October 14, 2016, Governor Chris Christie signed into law the legislation that he and Democratic leaders of the New Jersey Senate and Assembly had reached a compromise on at the end of September in an effort to replenish the now-depleted New Jersey Transportation Trust Fund.

Mainly in exchange for Governor Christie's acceptance of the higher gas tax, the Democratic leaders agreed to (1) lower the state's sales tax and (2) to phase out the New Jersey estate tax by 2018. The newly enacted legislation provides the following tax adjustments:

- Increase gas tax by $0.23 per gallon (effective November 1, 2016);
- Decrease NJ sales tax from 7% to 6.875% on January 1, 2017, and to 6.625% on January 1, 2018;
- Increase NJ Estate Tax exemption from $675,000 to $2 million for deaths in 2017, and eliminate the estate tax in full on January 1, 2018;
- Increase the Earned Income Tax Credit from 30 percent of the federal limit to 35 percent;
- Increase the gross income tax exclusion for retirement and pension income; and
- Create a new income tax deduction for veterans.

The New Jersey Estate Tax is a tax imposed on any New Jersey resident whose net estate has a value of more than $675,000 – the lowest exemption in the nation. Please note, however, that the new legislation fails to mention whether the New Jersey Inheritance Tax – which is a completely separate tax – would remain in place and unadjusted. It's presumed at this time that it would remain.

The New Jersey Inheritance Tax is a tax imposed on beneficiaries of a New Jersey estate based on the amount each beneficiary receives and the relationship to the decedent. Property received by "Class A" beneficiaries (i.e., spouses, parents, children and grandchildren) and "Class E" beneficiaries (i.e., qualifying charities) is exempt from the tax, which means that many estates do not incur the Inheritance Tax at all. However, the Inheritance Tax is due eight months from date of death (a month before the Estate Tax), and a return must be filed if any portion of the decedent's estate passes to someone other than a Class A beneficiary (e.g., sibling, niece or nephew). Further, unlike the Estate Tax, the New Jersey Inheritance Tax applies to non-residents who own real estate or tangible property located in New Jersey. However, under current law, only the higher amount of the Inheritance Tax and the Estate Tax is ultimately payable.

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In light of these changes, it would be prudent to review your current estate plan and discuss with your tax advisor whether revisions should be made. For example, your will or revocable trust plan might currently create a trust for the benefit of your spouse and children, to be funded at your death with the maximum amount that would not create a federal or New Jersey Estate Tax, with the balance of your estate passing outright to your spouse. Under such a funding formula, this change in the New Jersey Estate Tax exemption could dramatically shift the amounts allocated outright or in trust for your family, and the initial plan may have been established for purposes of saving state death taxes which may no longer be relevant. If you died in 2017, your plan would leave $2 million (instead of $675,000) in trust for your spouse and children; and, for a death in 2018, would leave more than $5,450,000 (the federal exemption amount this year) to that trust, since there would be no New Jersey Estate Tax exemption amount to act as a ceiling. In short, you might unexpectedly leave too much in trust for your family when an outright disposition to your surviving spouse might have been preferred. Individuals with these types of plans are encouraged to revisit their plans in the very near future.

Status of Valuation Discounts on Transfers of Interests in Family-Controlled Entities Uncertain

The future is unclear for new Treasury Regulations recently proposed by the Internal Revenue Service that would affect intra-family transfers of interests in closely-held family entities. Tax practitioners and members of Congress have leveled withering criticism of the proposed rules, as Treasury officials attempt to clarify their intended effect. The most controversial provisions of the proposed Regulations would modify the treatment of certain restrictions on liquidation for purposes of gift and estate tax valuations of intra-family transfers of interests in family-controlled entities.

When valuing such transfers, existing Regulations require that certain restrictions contained in the entity's governing documents regarding the owners' ability to liquidate the entity be disregarded. The Service views such restrictions as a technique to artificially lower the value of intra-family transfers for gift and estate tax purposes without actually restricting the family members' ability to liquidate the entity, as the family members could vote as a group to remove the restriction at any time.

The proposed Regulations would create a new category of restrictions that would be disregarded for purposes of valuing such transfers. In addition to disregarding certain restrictions on the ability of family members to liquidate the entity, the proposed Regulations would disregard any restriction that would (i) limit the ability of any individual family member to liquidate his or her interest in the entity, (ii) limit the liquidation proceeds to less than a "minimum value" (described in the proposed Regulations as the interest's proportionate share of the fair market value of the entity's underlying assets less certain outstanding obligations of the entity), (iii) defer payment of the liquidation proceeds for more than six months or (iv) permit payment of the liquidation proceeds in other than cash or property (which generally would not include promissory notes).

The proposed Regulations, as drafted, could significantly curtail the ability of a holder of an interest in a family entity to discount the value of such interest for gift or estate tax purposes on the basis of lack of control or lack of marketability, and would apply to operating businesses as well as investment entities. Tax practitioners have criticized the proposed Regulations as, at best, inconsistent with the economic realities of many family businesses and, at worst, an over-reach by the Service that exceeds its statutory authority to create new categories of disregarded restrictions. In a highly unusual move, Congress has weighed in as well. Two members of the House of Representatives have proposed separate bills, one of which has over 21 co-sponsors, to nullify the proposed Regulations. In addition, 41 Senate Republicans recently sent a letter to the Secretary of the Treasury requesting that the Treasury Department withdraw the proposed Regulations.

If enacted, the proposed Regulations would be effective on the date of enactment, for some purposes, and 30 days following the date of enactment, for other purposes. The Service likely will receive a flood of comments from tax practitioners and professional associations regarding the proposed rules, and a public hearing to discuss them is scheduled for December 1. At least one Treasury official has indicated that the Regulations will not be finalized by the end of the year, alleviating some concern that immediate action would be necessary to make intra-family transfers prior to the effective date. Also, in discussions with practitioners, Treasury officials have suggested the scope of the proposed Regulations is intended to be narrower than practitioners believe the actual language of the proposed Regulations indicates, so their potential effect on valuation discounts may be narrower than initially feared.

Although much uncertainty remains regarding the future of the proposed Regulations and the impact they will have, as well as the timing of the finalization of the new rules, clients looking to transfer minority interests in closely-held family entities to other family members should consider making those transfers sooner rather than later.

New York Adopts Legislation Providing Fiduciaries with Greater Clarity Regarding Access to Digital Assets

On September 29, 2016, Governor Cuomo signed into law legislation that adopts the core principles of the revised Uniform Fiduciary Access to Digital Assets Act ("RUFADAA") which has been previously adopted by a number of states. The RUFADAA is intended to clarify when a fiduciary has access to a "catalogue" of digital information so that a fiduciary can determine what digital accounts and information exist, and then whether that fiduciary has access to the "content" of this digital information. The RUFADAA generally applies to executors, trustees, attorneys-in-fact named under powers of attorney, and guardians.

Before enactment of the RUFADAA in New York, a fiduciary's right to digital information was generally governed by the custodian's Terms of Use that are generally agreed to by clicking "I agree" at the commencement of use of an on-line service. These terms of use frequently limit transferability of accounts and access to information, and access may terminate at the death of the subscriber.

Under the RUFADAA as adopted in New York, a fiduciary will generally have access to a catalogue of digital information unless the decedent specifically prohibited disclosure. Further, with respect to content (e.g., texts of emails, photographs, social media postings, etc.), the following rules generally apply:

- If the on-line service has a tool apart from the general terms of service that provides the user with the right to give specific direction regarding access by others, including an executor, trustee, attorney-in-fact or guardian, then that direction will generally govern and override provisions in a Will, trust or power-of-attorney;
- If the on-line tool isn't available, or available but not utilized, then specific authority in a Will, trust, or power of attorney would control access to the content of digital information; and
- If neither on-line tools provide direction, and the governing instrument (ie., Will, trust or power of attorney) doesn't provide specific direction, then the terms of service will generally govern.

Individuals should consider whether they want to provide or block access to fiduciaries to their digital information (including the content of what's been digitally recorded) and then make sure that their wishes are carried out by specifically addressing the matter with on-line tools where available, and also making sure that updated estate planning documents including Wills, trusts, and powers-of-attorney include authorizations consistent with their wishes.

New Jersey Uniform Trust Code Reminder

As the year-end approaches, trustees should consider how they intend to comply with New Jersey's recently enacted Uniform Trust Code (the "UTC").

As discussed in earlier alerts from February and May of this year, the UTC requires trustees to make certain disclosures to trust beneficiaries. Under the UTC, a trustee of a New Jersey irrevocable trust must now advise certain beneficiaries of the trust about the existence of the trust and keep such beneficiaries "reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests."

For individuals establishing new trusts after the UTC effective date, the law provides that the terms of a trust may override the duty to make disclosures to trust beneficiaries, with certain limits. If the trust terms so provide, the trustee does not have to make affirmative disclosures regarding the existence of the trust or its administration. However, notwithstanding any provision in the trust to the contrary, the trustee must respond to a request made by a "qualified" beneficiary of the trust (essentially, a current beneficiary or the person(s) next in line to benefit from the trust after the current beneficiaries) who is at least 35 years old for a copy of the trust instrument or other information reasonably related to the administration of the trust. The codification of this duty to respond to a beneficiary's request for information regarding a trust's administration does little to change the obligations of trustees under prior law, because beneficiaries were already entitled to demand that a trustee account for his or her acts and proceedings as trustee.

The UTC also contains a mechanism for trustees to protect themselves from later challenges by trust beneficiaries. Specifically, the UTC provides that a beneficiary of a trust may not commence a proceeding against a trustee for breach of trust more than six months after such beneficiary was sent a report that adequately disclosed the existence of a potential claim for breach of trust and informed the beneficiary of the six-month time frame allowed for commencing a proceeding. The report must contain adequate information regarding trust property, liabilities, receipts, and disbursements, including the source and amount of the trustee's compensation, a listing of the trust assets, and, if feasible, their respective market values.

If you have one or more existing trusts, or are serving as the trustee of one or more existing trusts, and would like to discuss how the new disclosure requirements will affect you, or if you were considering additional trust planning in the future but want to understand how these new rules will apply to any new trusts, please contact your attorney as soon as possible.

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