



WEALTH PLANNING > ESTATE PLANNING

## Communicating to Clients About Planning Uncertainty

*A sample letter and memorandum will get you started*

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From a federal estate tax perspective, there hasn't been much tax uncertainty since 2012. There's also never been a greater likelihood for a complete repeal of the federal estate tax and perhaps, the enactment, in its place, of a capital gains tax on death. This article, the last in a series of four articles, provides a sample client letter that can be modified by practitioners to communicate the results of reviewing a client's

will or revocable trust. This article also provides a generic client memorandum that can be tailored to the particular practice and state law; and used to inform clients of the changes brewing including actions they may need to take. In addressing state law considerations, both the sample letter and sample memorandum illustrate New Jersey law. Practitioners in other jurisdictions should tailor these documents to reflect their own states' laws.

## **Sample Client Letter Informing Client of Results of Will Review**

\*Date

\*Client Name

\*Client Address

Re: **Impact of Estate Tax Repeal on Your Estate Planning**

Dear Client Name:

As you requested, we've reviewed your wills [revocable trusts] dated [\*will date] solely to determine whether any modifications may be warranted as a result of the recent phased-out repeal of the New Jersey estate tax law. As you may now be aware, the New Jersey estate tax law increased the New Jersey estate tax exemption from \$675,000 in prior years, to \$2 million effective Jan. 1, 2017. Effective Jan. 1, 2018, the New Jersey estate tax is scheduled to be repealed. These changes are good news for our New Jersey clients and their beneficiaries. However, the estate tax changes will impact the operation of some of our clients' wills and revocable trusts.

There are two trusts provided for in your will on the death of the first spouse. The first is a credit shelter trust, which many refer to as a “family trust.” In your case, the surviving spouse and all descendants are the beneficiaries. While the trust states that the trustees should favor the surviving spouse, the needs of the other beneficiaries will have to be addressed as well. The second trust is a marital trust, often referred to as a qualified terminable interest property (QTIP) trust, and is solely to benefit the surviving spouse (and must pay all income at least annually to such spouse) during his or her lifetime. There are no other beneficiaries while the spouse is living.

Our review of your wills indicates that they [define dispositive scheme] incorporate trusts that are to be funded using a so-called estate tax exemption “formula” approach. As a result, the changes to the New Jersey estate tax will impact the manner in which the credit shelter trust and marital trust are funded upon the death of the first spouse. The wills direct that a credit shelter trust be funded at the first death with the largest amount that can pass to that trust without increasing either the state estate tax or the federal estate due by reason of your death. For example, if a spouse’s death were to have occurred before the end of 2016, the credit shelter trust would be funded with no more than \$675,000 (to defer any estate tax until the death of the survivor). This was the amount that was anticipated to go into that trust when you signed your wills. If a death were to occur during 2017, \$2 million will pass to the credit shelter trust because in 2017 the New Jersey exemption amount is \$2 million, which is less than the \$5.49 million federal exemption amount. If instead, the first spouse’s death occurs on or after Jan. 1, 2018, when the New Jersey estate tax is no longer in effect, the credit shelter trust could be funded to the full extent of the deceased spouse’s federal estate tax exemption, which under current law is \$5 million, indexed for inflation, or \$5.49 million in 2017. The balance of estate property, if any, not used to fund the credit shelter trust will pass to the marital trust for the sole use and benefit of the surviving spouse during his or her lifetime.

If the federal estate tax is repealed in 2018 or later, there will be no state or federal exemption amount. In such event, it’s not clear to whom assets would be allocated

under your will, because this possibility wasn't considered at the time your wills were drafted. Therefore, should the federal estate tax, in fact, be repealed, it's important that your wills be revised to clarify what should occur.

Since the credit shelter trust will likely be funded with a much larger sum than was initially anticipated, you have to determine whether you remain comfortable with the current design of your wills.

The trustees of the credit shelter trust and QTIP trust are the surviving spouse and [\*co-trustee name]. The surviving spouse is a beneficiary of both trusts. If you wish to modify the terms of the credit shelter trust, limit the funding amount or perhaps eliminate the credit shelter trust altogether in favor of alternative planning, please let us know.

The credit shelter trust established under your wills allows the trustees, in their discretion, to distribute the net income and principal of the trust to the surviving spouse and your descendants for each such recipient's needs regarding health, education, maintenance and support. Also, an independent trustee, if any, has the discretionary power to distribute the net income and principal of the trust to the surviving spouse and your descendants, for any purpose (that is, not limited as above). Moreover, in the exercise of such discretion, the trustees may consider the needs of the surviving spouse as more important than the needs of your descendants or any other beneficiary. Finally, the surviving spouse has been given a testamentary limited power of appointment over the credit shelter trust in favor of your descendants. This power allows that spouse, by an express direction in his or her will, to change the manner in which the trust property would ultimately pass among your children and more remote descendants. This provides flexibility for changed circumstances over time.

Again, the trustees of the credit shelter trust are the surviving spouse and [\*co-trustee name]. It's important that you remain comfortable with such person having that degree of authority and, in particular, if that authority could be exercised over the entirety of the estate.

Given that the surviving spouse is both a beneficiary and a trustee of the credit shelter trust, has been given liberal access to the trust property and such spouse's needs may be given preference over the needs of your descendants, you may not have any concern over the shifting of estate assets between the QTIP trust and credit shelter trust. However, please remember that appreciated property held in the credit shelter trust won't get a step-up in basis on the surviving spouse's death.

You should also note that because your wills are more than [\*number] years old, we encourage you to contact us about scheduling an appointment to review your estate plan. Also, changes to your documents may be required at some future date in the event President Trump and his administration were to successfully repeal the federal estate tax.

**[Alternate language that may be used for wills with contingent disclaimer trust.** Our review of your wills indicates that they don't incorporate credit shelter trusts that are funded using a so-called estate tax exemption "formula" approach (that is, the funding of a credit shelter trust isn't tied to the New Jersey estate tax exemption or the amount that could pass free of federal or state estate tax). Rather, your wills include a contingent "disclaimer trust" to provide flexibility for post-mortem estate tax planning by allowing the surviving spouse, if appropriate, to renounce and disclaim all or a portion of his or her inheritance into a credit shelter trust. As a result, the changes to the New Jersey estate tax law won't impact the operation of your wills. Therefore, no changes need be made to your wills at this time solely as a result of the recent changes to the New Jersey estate tax law. However, as your wills are more than [\*number] of years old and some of your testamentary goals may have changed, we encourage you to contact us about scheduling an appointment to review your estate plan.]

Please contact us if you have any questions regarding the above or if you would like to discuss this matter in more detail.

Very truly yours,

\*Firm Name

## Generic Client Memorandum about Repeal Implications

### MEMORANDUM

TO: Our Clients and Friends

FROM: \*NAME Law Firm

RE: New Jersey Estate Tax Phased Out; Federal Estate Tax May be Repealed

DATE: \*DATE

On Oct. 7, 2016, the New Jersey legislature voted to pass a bill that will eliminate the state's estate tax. Governor Chris Christie signed the bill into law on Oct. 14, 2016.

The bill phases out the estate tax over two years, by raising the exemption amount to \$2 million for decedents dying on or after Jan. 1, 2017, and eliminating the estate tax altogether for decedents dying on or after Jan. 1, 2018. Prior to 2017, New Jersey provided an estate tax exemption amount of only \$675,000. This means, in general, that a decedent's estate that passes to a non-spouse in 2017 may be subject to New Jersey estate tax if the decedent's taxable estate exceeds \$2 million.

While the new law will exempt most New Jersey families from the need to pay estate tax on the death of a loved one, the New Jersey inheritance tax wasn't eliminated. The estates of decedents who bequeath property to individuals other than spouses, children, grandchildren and more remote descendants (all of whom are exempt beneficiaries) may still incur significant inheritance taxes regardless of the repeal of the estate tax. Currently, bequests to siblings or spouses of children, which exceed \$25,000, are taxable at rates ranging from 11 percent to 16 percent, and bequests of

more than \$500 to all other non-exempt beneficiaries are taxed at rates between 15 percent and 16 percent.

All existing wills and revocable trusts of New Jersey residents should be reviewed to determine whether changes are necessary to reflect the phased repeal of the New Jersey estate tax, as well as the potential impact of a repeal of the federal estate tax. While the fate of the federal estate tax is uncertain, in many instances revisions to wills and revocable trusts, and other more sophisticated planning, will still be worthwhile:

- Some documents for a married couple rely on a simple and flexible approach to planning. The entire estate is left outright to the surviving spouse, and the surviving spouse is granted the right to “redirect” any portion of those assets to a credit shelter trust via a “disclaimer” or renunciation. If your documents contain this type of plan, there should, in general, not be a need to modify the documents or plan for changes in the New Jersey or federal estate tax. However, this type of plan does raise other issues, for example, if the surviving spouse doesn’t disclaim, assets inherited could be exposed to the risks of a new spouse.
- Wills and revocable trusts that create so-called “credit shelter,” “bypass” or “family” trusts may contain estate tax-oriented formulas that could have the unintended consequence of reducing (or even eliminating) bequests to the surviving spouse, or other intended family members. In particular, for taxpayers with assets less than the current federal estate tax exemption of \$5.9 million, such trusts may no longer meet a family’s planning objectives and may be disadvantageous from the standpoint of reducing future capitals gain tax via basis maximization at death. If the federal estate tax is also repealed, without carefully evaluating the terms in the will or revocable trust, it may not be possible to determine what will happen to the estate property. Generalizations could be dangerous.

If you have any questions regarding or would like to schedule an appointment to review your existing documents, please call our office at [\*number].

Sincerely,

Name of Firm

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