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Re: Checking the Details in Estate Planning

Dear Clients, Friends and Colleagues:

When planning your estate, you have, no doubt, considered the "big picture" issues: Who inherits what? Do I need a living trust? How can I mitigate estate taxes? How do I best protect my spouse and my children? Do my children need the protection afforded by a trust? On many occasions, we meet with new clients and ferret out important details that have been overlooked in their prior planning. As the adage goes, "The Devil is in the Details"; in estate planning, the details can have a dramatic impact on the distribution of your estate to your intended beneficiaries, the estate tax liability and how much of the estate tax burden each beneficiary has to bear. Listed below are some of the most common overlooked estate planning details.

**Tax Planning:** Even if your estate is exempt from the federal estate tax, New Jersey (or other states) estate taxes should be anticipated by your estate plan; the goal should be to mitigate them whenever possible. This includes proper drafting of your Will to plan for possible changes in the current tax law such that your estate plan remains flexible enough to accommodate the tax law changes wherever possible.

Estate taxes may be paid by the estate, or if a proper Will is executed, the estate tax can be paid from the amount inherited by each beneficiary. Often times, people will name friends as beneficiaries of their IRA's or hold assets in joint ownership with rights of survivorship; such assets are not governed by your Will. This may result in the estate tax attributable to such assets, which pass outside of your probate estate, being paid out of the assets of your estate that pass, pursuant to your Will, to other beneficiaries. As a result, the beneficiaries of your Will receive less because their share of your estate is burdened by estate taxes on assets that have been transferred to someone else.

**Executor's Access to Documents:** The Executor must be able to access your important papers in order to locate assets and collect on them. It is important to leave a source and instructions and – just as importantly – how your assets are accessed electronically. You should prepare a list of significant assets, where they are located, identifying information such as account numbers, and account names and your passwords. If your Executor does not have ready access to this information, unnecessary time and resources may be expended to locate the assets. This list should also include a list of creditors, to help the executor verify or refute creditor claims.

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**Beneficiary Designations on IRA's, Annuities, and Employer's Pension and Profit Sharing Plans:** Generally, qualified retirement accounts are transferred by the beneficiary designation and pass outside of your Will to the designated beneficiary who receives the assets automatically on your death without regard to the provisions of your Will. To make these arrangements, submit a beneficiary designation form to the financial institution or your employer's retirement plan administrator. Be sure to keep the beneficiary designations current, and provide instructions to the executor so that he or she is aware of these assets, which generally are not governed by your Will. Under applicable income tax laws, if a person fails to name a beneficiary of his qualified retirement account, the IRA asset passes to his/her estate and may result in the entire balance being subject to income tax which could otherwise have been postponed by having the account roll-over into another qualified retirement account. A trust may be named as a beneficiary without adverse income tax consequences, if the trust has been properly drafted to accommodate ownership of a qualified retirement account as required by current law. The income tax burden on qualified retirement accounts can be significant if a properly executed plan is not in place. You should also consider naming a contingent beneficiary.

**Liquid Funds:** Is there enough available cash to cover your family's expenses while the estate is settled? The estate may have to pay court costs, your debts and living expenses for a surviving spouse or other dependents. Your estate plan should foresee some of the issues that exist with regard to liquidity and you should execute a plan to avoid or mitigate the financial burden that may exist during the administration of your estate.

**Fund the Living Trust:** Many people establish living trusts but fail to fully implement them, thereby reducing or eliminating the trust's potential benefits. To be governed by the trust, an asset's ownership must be legally transferred into the trust and/or the Will must be a "pour over" Will (meaning that the assets of the estate pour over to the trust). If legal title to homes, vehicles or financial accounts is not transferred into the trust, the trust is of no effect and the assets must be probated. Generally, in New Jersey, if assets are moved into the Living Trust, a tax waiver is not required which results in the Trustee having full access to the entire account during the administration process.

**Life Insurance Beneficiary Designations:** Life insurance policies are assets that can be transferred directly to a beneficiary based on the insurance contract. Life insurance proceeds are includable in the estate of the decedent if the decedent owned the policy at the time of his death, or if the estate is the beneficiary of the policy. With proper planning, the insurance proceeds may be removed from the decedent's taxable estate generally without any adverse impact on your lifetime gift exemption or your estate tax exemption amount.

**Cross Planning for Income and Estate Tax:** As a rule of thumb, for income tax purposes, the tax cost basis of most inherited assets (notable exception: IRAs) is "stepped up" to their fair market value as of the date of the decedent's death. This means that the beneficiaries who receive such assets from the Estate are not subject to capital gains taxes on those assets and hold such assets with an increased basis, the assets' fair market value.

Capital gains tax rates have increased significantly (in New Jersey, the long term capital gains can approach 33%). Now that the federal estate tax exemption has stabilized north of \$5 million, estate planning should, in many cases, focus on income tax savings for one's beneficiaries.

Accordingly, wherever possible, estate plans should provide for retention of low cost basis assets so that the maximum basis step up can be achieved thereby saving taxes for beneficiaries.