

Trust & Estates

Taxes and Planning

TM Financial Services

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Qualified Funeral Trust - §685

A pre-need funeral trust is an agreement between a purchaser and a funeral home in which the funeral home contracts to perform certain funeral or cemetery services at the purchaser's death.

Prior to 1997, most pre-need funeral contracts were treated as grantor trusts in compliance with Rev.Rul. 87-127. A unique statement was required to be sent to the purchaser listing each item of income and expense. Confusion arose as the reporting instrument was neither a 1099 nor a Schedule K-1 but a hybrid combination of Schedules B & D.

The difficulties of the funeral industry in complying with Rev.Rul. 87-127 led to an alternative offered by Congress – a code section 685 Qualified Funeral Trust. The requirements that must be met for a trust to qualify are:

- Contract is with a person engaged in the business of providing funeral services.
- The trust's only purpose is to hold and invest funds to pay for funeral or burial services.
- The trust's only beneficiary is whoever the services are to be provided for

NJ Estate Simplified Tax System

Some labels are not indicative of their true characteristics. A case in point – the option to use the simplified form method when preparing the NJ estate tax return, form IT-Estate.

This method, sanctioned under the Simplified Tax System (STS) – N.J.S. 54:38-1a(2)(a) allows one to compute the tax and submit a NJ estate return without filing the usual pro forma 2001 Federal Form 706. If a federal estate tax return must be filed, then use of the STS is not allowed and the Form 706 (2001) method has to be used. This requires submitting along with a NJ estate return, a copy of the Federal Form 706 being filed and a pro forma 2001 Form 706 from which the values are extracted to populate the NJ estate return.

As mentioned, if a federal return is not required, one can use the simplified form method and attach a copy of the NJ Inheritance return, IT-R.

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NJ - STS (continued from page 1)

According to the IT-Estate instructions, the simplified form method is intended to produce a NJ tax similar to that produced by the Form 706 method. In fact, it may not be used in situations where the tax produced is not similar to the tax under the pro forma 2001 Form 706 alternative.

In order to ensure a similar tax liability, there are a number of additions required to be made to the net estate for Inheritance tax purposes in effect at 12/31/01 if the STS is to be used:

- Real & tangible property located outside NJ
- Proceeds of life insurance payable to a named beneficiary or any life insurance transferred within three years of death.
- Other transfers within three years of death not included in the Inheritance Tax net estate.
- QTIP received from predeceased spouse for which a marital deduction was taken.
- Any other property includable in the federal gross estate under IRS provisions in effect on 12/31/01.

Two of the most common other property add backs would include proceeds of a pension, annuity or retirement plan payable by the US Government and payments at death under the NJ Teachers pension & annuity fund, both payable to other than surviving spouse.

Even after allowing for these modifications, there may be material difference between the two methods.

One difference is that the NJ Inheritance tax allows a deduction for outright transfers to a

spouse but not for transfers in a QTIP trust. Obviously, if QTIP property is significant, the Form 706 method would be preferable or even required.

Gifts made within three years of death are taxable under the STS but not those made over three years prior to death. Again, in some estates this could produce a significant difference from the 706 method thereby denying its use.

The election to use the alternate valuation date is not permitted on the IT-R and so using the STS would not allow for that opportunity to reduce taxes.

Because of these complications, many practitioners prefer to use the Form 706 method even when a federal return is not required (which is now often the case), rather than deal with the difficulties of the so-called simplified form method.

Could anyone other than New Jersey come up with a simplified method more complicated than the alternative scheme?

§ 685 (continued from page 1)

- The only contributions are for the benefit of the trust's beneficiary.
- Trustee elects special tax treatment.
- Other than for making election, the trust would be treated as a grantor trust.

If the trust qualifies, the income tax of the trust will be paid by the trustee and reported by filing Form 1041-QFT. Once made the election is irrevocable. The trust will continue to qualify for the period between the decedent's death and the distribution of the trust assets to the provider of services. However this period cannot exceed 60 days.

GENERATION SKIPPING TRANSFER TAXES

DIRECT SKIPS

INDIRECT SKIPS

Payable by Transferor	Payable by Estate	Payable by Certain Trusts	Gifts to Trusts not currently subject to GSTT	Taxable Distributions	Taxable Terminations
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Inter vivos

Form 709
Schedule A
Part 2

Form 709
Schedule A
Part 3

Form 706-
GS(D)

Form 706-
GS(T)

Post mortem

Form 706
Schedule R
(2)

Form 706
Schedule R-1

Form 706-
GS(D)

Form 706-
GS(T)

Taxes paid by

Transferor

Estate

Trustee

No tax

Beneficiary
(1)

Trustee

(1) A payment of the GSTT by the trust is an additional taxable distribution

(2) Including a QTIP trust here on Schedule R (Part 1, Line 9) will treat the property as having been transferred by decedent for GSTT purposes only (Reverse QTIP election)

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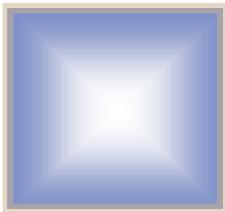
IRS	General Information	800-829-1040
	EINs	800-829-4933
	Form 706 & 709	866-699-4083
NJ	General Information	609-826-4400
	Estate & Inheritance	609-292-5033
NY	General Information	518-457-5181
	Estate Tax	518-457-5387
CT	General Information	860-297-5962
PA	General Information	717-787-8201

Credit for prior transfers – Form 706, Schedule Q

The estate of a decedent is entitled to a credit against estate taxes for the tax paid on prior transferred property (PTP). It is based upon the amount of estate tax paid with respect to property transferred to the decedent within certain time frames. If the transferor died within two years of the decedent then the credit is the full amount. If transferred within the third or fourth year before the decedent's death the credit is 80%; within the fifth or sixth years – 60%; within the seventh or eighth years – 40% and within the ninth or tenth years – 20%. The estate of the transferor had to be subject to a federal estate tax and the transferred property included in his gross estate. The credit is limited to the lesser of:
Value of transferred property x Transferor's estate tax or The amount of the federal estate tax attributable to the transferred property in the decedent's estate.

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