

# Changes to Connecticut's Estate and Gift Taxes

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**CATEGORY:**

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## Connecticut Estate and Gift Tax Exemption Amounts Reduced Retroactively

Connecticut's estate tax exemption has been reduced from \$3.5 million to \$2 million. The new exemption amount is applicable to the estate of a decedent dying on or after January 1, 2011. The new law also reduces Connecticut's gift tax exemption amount to \$2 million (from \$3.5 million) for Connecticut taxable gifts made on or after January 1, 2011. The Connecticut gift tax exemption amount applies to all Connecticut taxable gifts made since the tax was enacted on January 1, 2005. Connecticut taxable gifts include gifts of (i) Connecticut real property made by anyone, (ii) tangible personal property situated within Connecticut made by anyone, or (iii) intangible personal property made by Connecticut residents.

### *Estate and Gift Tax Rates*

The new law maintains the existing graduated estate and gift tax rates. The rates begin at 7.2% for transfers over \$2 million up to a maximum of 12% for transfers over \$10.1 million. There is no "cliff" tax once the exemption amount is exceeded, as was the case from 2005 – 2009.

## Connecticut Estate Tax Return Required

All estates, regardless of size, are still required to file estate tax returns, including estates of nonresident decedents with Connecticut real or tangible property. If an estate is over the tax exemption amount, \$2 million, the return is filed with the Connecticut Department of Revenue Services, with a copy to the local probate court. Smaller estates only file the return with the probate court.

## Coordination of Federal and State Estate and Gift Tax Planning

Under Federal tax law, each individual has a maximum lifetime exemption amount for estate and gift tax purposes. The 2010 Tax Act unified the Federal gift, estate and generation-skipping transfer ("GST") tax exemptions at \$5 million. As the law currently stands, the 2010 Tax Act will expire on December 31, 2012 and the rates will then revert to their 2001 levels (\$1 million gift and estate tax exemption, an indexed GST tax exemption (currently indexed at approximately \$1.4 million and a 55% maximum tax rate).

### *Connecticut Decoupled Tax Planning*

Since Connecticut imposes a separate estate tax and the Connecticut estate tax exemption is autonomous from the Federal amount, Connecticut is considered to be a "decoupled" state for estate tax purposes. The consequence of living in a decoupled state is that an estate that was intended to pass everything free of tax on the death of the first spouse may be free of tax for Federal purposes but subject to state estate taxes. The state estate taxes may be significant.

As an example, a married couple has an estate plan that passes the amount that can pass free of Federal tax to a trust for the benefit of the spouse. This type of trust is commonly called either a "credit-shelter" or "by-pass" trust. The plan then leaves the remaining estate outright (or in a marital trust) to the surviving spouse. Assuming the husband dies first and his estate is valued at \$5 million, upon the husband's death there would be no Federal estate tax due; however, Connecticut would be owed \$229,800. If instead the married couple's plan passes the amount that can pass free of Federal and Connecticut tax, no tax would be due on the husband's death.

Quite often couples with large estates prefer to pay a tax upon the death of the first spouse in order to maximize the amount passing to a trust that will grow free of further estate taxation. However, the large tax bill from Connecticut may still be a shock to the surviving spouse. In more modest estates the surviving spouse is typically more concerned with ensuring there are enough assets available for her support and is displeased to find that a large check is owed to Connecticut.

Blended families and families with unique dispositive plans may also experience unintended outcomes as a result of the changing exemption amounts. A common plan in second marriages is to leave the exemption amount to children from the first marriage, and the remaining estate in a marital trust for the surviving spouse. If the estate plan was drafted prior to 2005 (before Connecticut decoupled), it is likely that the documents only refer to Federal exemption amounts, meaning that \$5 million will pass to the children from the first marriage, the Connecticut estate tax of \$229,800 must be paid and then any remaining assets will pass to the surviving spouse.

### *Portability*

Another change in the 2010 Tax Act was the introduction of "portability." Previously, if a decedent did not have enough assets in his own name to use all (or part) of his exemption, the unused exemption was lost. Now a surviving spouse may inherit any unused exemption remaining from the

first spouse to die. If a couple made no lifetime gifts and did no estate planning, the surviving spouse can inherit the entire \$5 million exemption and will then have a \$10 million exemption that can be used either during life or at death.

Depending on your assets and family circumstances, portability may work very well with a decoupled Connecticut estate plan. While portability is a great option for people who have failed to plan, there are some shortcomings. One limitation is the loss of asset protection by not utilizing a credit-shelter type trust. Additionally, all the asset growth is included in the survivor's estate. When using a credit-shelter trust the asset growth escapes future estate tax. It should also be noted that only the estate tax exemption may be passed to a spouse. If a couple wishes to utilize GST tax planning, a trust needs to be created upon at the first spouse's death. In addition, Connecticut does not have portability with respect to its \$2 million exemption amount.

In order to claim the benefit, an estate tax return must be filed. The law also prevents the piling up of exemptions through a series of marriages. Only the exemption from the most recently deceased spouse may be used.

A key drawback of relying on portability is that under current law it is only around for two years. A spouse must die in 2011 or 2012 in order for the surviving spouse to inherit any unused exemption.

#### *Planning Can Provide Tax Savings*

Taxes are an important cost consideration in wealth transfer planning. We have developed strategies for our clients that effectively result in tax savings. The appropriate strategy depends on individual and unique family facts and circumstances. Now is an opportune time to take advantage of certain Federal tax planning opportunities that are available for only a limited time.

#### Conclusion

You should review your estate plan to ensure the recent changes in the Federal and most recently Connecticut law do not cause unexpected results. Your Withers Bergman attorney will be happy to assist you. Additionally, since the changes made by the legislature are retroactive, you should review any gifts already made this year along with any future planned gifts to ensure there are no surprises come tax time next April.

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