

How the new federal and Connecticut estate and gift tax exemption could affect your estate plan

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Current federal and state estate tax exemption:

Federal law: On December 22, 2017 the President signed into law legislation that represents the most sweeping tax reform in decades (the "Act"), and generally takes effect on January 1, 2018. Prior to the Act being signed into law, the federal estate and gift tax exemption was US\$5.49 million for 2017. However, the Act increases the federal estate and gift tax exemption to US\$11.18 million (US\$22.36 million for married couples) starting January 1, 2018. In addition, the Act also increases the per person generation-skipping transfer (GST) tax exemption to approximately US\$11.18 million. Under the Act, absent additional legislative action, the increased exemptions will remain in effect through 2025, after which the exemptions will return to the 2017 federal estate tax exemption (adjusted for inflation).

Connecticut law: On October 31, 2017 Connecticut increased the **Connecticut** estate and gift tax exemption. Starting on January 1, 2018 the estate and gift tax exemption increases from US\$2 million to US\$2.6 million, and it will again increase from US\$2.6 million to US\$3.6 million on January 1, 2019. Effective January 1, 2020, the exemption will increase to the federal estate tax exemption.

How this could affect your estate plan:

A very common estate planning technique for married couples is to fund a trust with the maximum amount that can pass free of **federal** estate tax with the rest of the estate being sheltered by the unlimited marital deduction, resulting in no estate tax due on the death of the first spouse. However, Connecticut has decoupled its estate tax exemption from the federal exemption until 2020, and therefore, Connecticut residents are forced to make a decision. If at death the taxpayer wants to put the total amount they are able to pass free of **federal** estate tax into a trust they will incur a **Connecticut** estate tax in 2018 and 2019. Alternatively, the taxpayer can fund a trust with only the amount that can pass free of **both** Connecticut and federal estate tax in order to not incur any estate tax on the first death. Although decoupling is not something new to Connecticut residents, the new laws significantly impact the way a Connecticut family decides to structure their estate plan.

With the passage of the new tax law and increased **federal** estate tax exemption, the cost of decoupling is bigger than ever before. An estate plan which directs the full amount that can pass free of **federal** estate tax into a trust will incur US\$867,000 in* Connecticut* estate taxes since the Connecticut estate tax exemption is only US\$2.6 million in 2018. In 2019, the additional cost will be US\$795,000, however, in 2020 Connecticut's exemption is scheduled to rise to the federal exemption and there is no additional cost.

How this could affect your ability to give tax free gifts:

If you have previously gifted US\$2 million or less of Connecticut property, in 2018 you can gift an additional US\$600,000 of Connecticut property without having to pay a Connecticut tax on the gift. In 2019 if you have not exceeded the 2018 **Connecticut** gift tax exemption of US\$2.6 million you can give a lifetime total of US\$3.6 million of Connecticut property, without paying tax on the gift.

Additionally, Connecticut residents who have previously paid **Connecticut** gift tax on gifts that exceeded the Connecticut gift tax exemption can still take advantage of the new Connecticut gift tax exemption. Connecticut provides a credit to people who previously paid taxes on gifts that exceeded the US\$2 million Connecticut gift tax exemption. For example, if a Connecticut resident gifted the federal amount of US\$5.12 million in 2012, they would have paid US\$240,000 in **Connecticut** gift tax. That resident can now give only US\$430,000 in 2018 or US\$1,143,461 in 2019, without paying any additional **Connecticut** gift tax. If that same person did give the full US\$600,000 (the additional Connecticut exemption amount) in 2018, that would generate US\$17,000 in Connecticut gift tax. This less than dollar for dollar increase is due to the progressive tax rate.

What should you do?

Structuring your estate plan to minimize Connecticut estate tax for the next two years will depend on the value of your estate, your age, and your family situation. There are a number of options available that forgo the full use of the entire **federal** estate tax exemption and will result in no **Connecticut** estate tax being incurred on the death of the first spouse prior to 2020. This is likely a desirable option for young families or families that have an estate of less than US\$30 million. Various types of marital trusts, outright marital bequests and devises, and* federal* portability can be effectively used to avoid Connecticut estate and gift tax on the first death, while preserving the benefit of the full federal exemption.

An alternative option is to fund a trust with the amount that can pass free of **federal** estate tax, which is US\$11.2 million in 2018. This will result in a larger amount passing free of **federal** estate tax to the surviving spouse and children; however, there will be a significant **Connecticut** estate tax prior to 2020. This is likely more advantageous for families with estates significantly larger than the couples' combined **federal** estate tax exemption.

Next Steps:


This Tax Alert cannot effectively address or even summarize the myriad of changes imposed by the Act and does not cover many other changes that might affect your particular situation. Because your situation is unique, this Tax Alert also does not provide tax or planning advice tailored to your exact circumstances. We therefore invite you to contact us to review your estate planning and discuss tax planning considerations with you in light of the Act. To determine what impact tax reform will have on you and what opportunities exist, you should speak with your Withers Bergman attorney.

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