



Search the complete LISI<sup>®</sup>, ActualText, and LawThreads<sup>®</sup> archives.

Search archives for:

Find it

Newsletters

[Click for Search Tips](#)

[Click for Most Recent Newsletters](#)

### Steve Leimberg's Estate Planning Email Newsletter - Archive Message #1540

**Date:** 26-Oct-09  
**From:** Steve Leimberg's Estate Planning Newsletter  
**Subject:** Connecticut's Estate Tax Reform Breaks the Mold

Earlier today, **LISI** alerted members to breaking news from Washington on the issue of estate tax reform. See **LISI Estate Planning Newsletter #1539**. As members well know, uncertainty over federal estate tax reform has also had a significant impact at the state level.

In their timely commentary, **Irving Schloss** and **Elizabeth Leamon** provide members with an analysis of how one state, Connecticut, has attempted to deal with the issue of estate tax reform.

**Irving S. Schloss** is a partner at the law firm of **Murtha Cullina LLP**. A resident in the firm's Madison and New Haven, Connecticut offices, Irv focuses his practice on trust and estate planning and administration. He is a Regent of ACTEC, a member of various of its committees, and the editor of ACTEC Studies. He is a member of the Executive Committee of the Connecticut Bar Association's Section of Estates and Probate Section. He has written and published numerous articles in national estate planning journals. His book, Understanding TIAA-CREF, which he co-authored with Deborah Abildsoe, deals with general issues of estate and retirement planning and was published in 2000 by Oxford University Press. A second edition is underway. His e-mail address is [ischloss@murthalaw.com](mailto:ischloss@murthalaw.com).

**Elizabeth L. Leamon** is an associate at the Madison, Connecticut

office of **Murtha Cullina LLP**, where she practices in the area of wealth management, including estate planning, estate settlement and probate litigation. Her e-mail address is [eleamon@murthalaw.com](mailto:eleamon@murthalaw.com).

Here is their commentary:

## **EXECUTIVE SUMMARY:**

Not a tax-friendly state by tradition, Connecticut may have inadvertently begun the process of unraveling state taxation of estates. Effective January 1, 2010, Connecticut will raise its gift and estate tax exemptions from \$2 million to \$3.5 million. The state will also lower rates by reworking the state death tax credit table. This has broad implications for multi-jurisdictional estates by creating a dichotomy among de-coupled states and a fracture in the computation of interstate credits for taxes paid. If other states follow the Connecticut example, the once fairly harmonious division of estate taxation among the states may come unglued.

## **FACTS:**

On September 1, 2009, the Connecticut General Assembly adopted a two-year budget. The Governor did not veto the bill, and it became law a week later. The new taxes include a higher income tax for individuals earning more than \$500,000 and married couples filing jointly earning more than \$1 million annually. The legislature adopted a trade-off by reducing the tax burden on estates through a combination of higher exemptions and lower rates. The new rates put Connecticut out of step with other states and may increase the problems of state taxation of estates, especially those with property in more than one state.

## **COMMENT:**

In a stunning development, the Connecticut legislature has restructured the state's estate and gift taxes effective for decedents dying or gifts made on or after January 1, 2010. Remarkably, the state has raised its estate and gift tax exemptions and lowered both sets of tax rates.

As described in detail below, these changes may appear of little general interest; however, they have broader implications for the entire system of states that de-coupled from the Federal system and have, therefore, their own state estate tax.

As of January 1, 2010, the Connecticut estate and gift tax exemptions will rise from the current \$2 million to \$3.5 million. Assuming that the 2009 Federal estate exemption is extended by Congress, the Federal system and the Connecticut system would, putting prior taxable gifts to one side, become synchronized. If Congress maintains the gift and estate tax exemptions at that level, the Federal and Connecticut systems would generally harmonize.

As illustrated by the two tables below, the estate and gift tax rates would decrease by about 25% once an estate or aggregate Connecticut taxable gifts exceeded the applicable exemption.

**Table 1**  
**Applicable to Estates of Decedents Dying Between 2005-2009**

<u>Amount of Connecticut Taxable Estate</u>	<u>Rate of Tax</u>
Not over \$ 2,000,000	None
Over \$ 2,000,000 but not over \$ 2,100,000	5. 085% of the excess over \$ 0
Over \$ 2,100,000 but not over \$ 2,600,000	\$ 106,800 plus 8% of the excess over \$ 2,100,000
Over \$ 2,600,000 but not over \$ 3,100,000	\$ 146,800 plus 8. 8% of the excess over \$2,600,000
Over \$ 3,100,000 but not over \$ 3,600,000	\$ 190,800 plus 9. 6% of the excess over \$ 3,100,000
Over \$ 3,600,000 but not over \$ 4,100,000	\$ 238,800 plus 10. 4% of the excess over \$ 3,600,000
Over \$ 4,100,000 but not over \$ 5,100,000	\$ 290,800 plus 11. 2% of the excess over \$4,100,000

Over \$ 5,100,000 but not over \$ 6,100,000	\$ 402,800 plus 12% of the excess over \$ 5,100,000
Over \$ 6,100,000 but not over \$ 7,100,000	\$ 522,800 plus 12. 8% of the excess over \$6,100,000
Over \$ 7,100,000 but not over \$ 8,100,000	\$ 650,800 plus 13. 6% of the excess over \$7,100,000
Over \$ 8,100,000 but not over \$ 9,100,000	\$ 786,800 plus 14. 4% of the excess over \$ 8,100,000
Over \$ 9,100,000 but not over \$ 10,100,000	\$ 930,800 plus 15. 2% of the excess over \$ 9,100,000
Over \$ 10,100,000	\$ 1,082,800 plus 16% of the excess over \$ 10,100,000

The table above should look familiar, because, once one passes the first bracket above \$2 million, Connecticut, like many other states, adopted the state death tax credit table, eliminating the old \$60,000 exemption, as the basis for assessing tax.

The table below will come into effect on January 1, 2010.

**Table 2**  
**Applicable to Estates of Decedents Dying on or after January 1, 2010**

<u>Amount of Connecticut Taxable Estate</u>	<u>Rate of Tax</u>
Not over \$3,500,000	None
Over \$3,500,000 but not over \$3,600,000	7.2% of the excess over \$3,500,000

Over \$3,600,000 but not over \$4,100,000	\$7,200 plus 7.8% of the excess over \$3,600,000
Over \$4,100,000 but not over \$5,100,000	\$46,200 plus 8.4% of the excess over \$4,100,000
Over \$5,100,000 but not over \$6,100,000	\$130,200 plus 9.0% of the excess over \$5,100,000
Over \$6,100,000 but not over \$7,100,000	\$220,200 plus 9.6% of the excess over \$6,100,000
Over \$7,100,000 but not over \$8,100,000	\$316,200 plus 10.2% of the excess over \$7,100,000
Over \$8,100,000 but not over \$9,100,000	\$418,200 plus 10.8% of the excess over \$8,100,000
Over \$9,100,000 but not over \$10,100,000	\$526,200 plus 11.4% of the excess over \$9,100,000
Over \$10,100,000	\$640,200 plus 12% of the excess over \$10,100,000

The new table eliminates the tax of assets below the exemption amount, as is now the case, and reduces the base amounts and the percentages to use in calculating the tax.

The interesting issues created by this new table arise in the context of the multi-jurisdictional estate. If one looks at the effect of having a \$10.1 million Connecticut estate, 10% of which consists of real estate located in another state that uses Table 1, the tax imposed by the other state, say New York or Massachusetts, will equal \$108,280. When one computes the Connecticut tax, the state allows a credit for taxes paid to other states equal to the lesser of (i) the actual tax paid or (ii) the fraction of the gross estate represented by the out-of-state property multiplied by the Connecticut tax. In this case, the credit allowed will equal \$64,020. The estate will have paid roughly \$44,000 more in tax than it receives as a

credit.

Conversely, a non-resident Connecticut estate with the same numbers, but with 10% of the value in Connecticut and 90% in the domiciliary state, will pay less than the allocation made by the domiciliary state to the Connecticut property. Subject to the constitutional issue discussed below, the domiciliary state will often only give a credit equal to the Connecticut tax paid. In that case, who gets the \$44,000 "windfall"—the estate or the domiciliary state?

These simple examples illustrate the unintended consequences that occur when one or more states start to play by different rules. A Connecticut resident will want to convert his out-of-state property, if located in a state death tax credit table state, into intangible personalty, say by transferring the property into a two or more member LLC, and coming under the more favorable Connecticut tax umbrella.

The Rhode Island resident owning property in Connecticut with an estate over its new exemption of \$850,000 and below \$3.5 million, will want to do the opposite, because a non-resident Connecticut estate worth less than \$3.5 million will pay no Connecticut tax. If overall taxes are reduced, out-of-state residents with larger estates and Connecticut property will want it taxed by Connecticut.

We looked at the statutes of certain eastern commercially important states with an estate tax, namely, Delaware, Massachusetts, New Jersey, New York and Rhode Island, to see if they use the state death tax credit table to compute their taxes. They all do.

Based on a review of the statutes only, a majority of the reviewed states follow the Connecticut pattern to compute the credit for out-of-state estate tax payments, namely, the lesser of:

- (i) the actual tax paid or
- (ii) the fraction of the gross estate represented by the out-of-state property multiplied by the state death tax credit table.

The exceptions are Rhode Island, whose statute only taxes in-state property, and New York whose statute invariably uses the state death tax credit table to compute the credit allocable to out-of-state property.

The statutory lack of fit poses a constitutional problem as well. The

issue first arose in Connecticut in 2005-2006. The Connecticut Department of Revenue Services asked the Attorney General what to do about real or tangible personal property located in states like Florida that had no state estate tax.

In an opinion issued on August 1, 2006, the Connecticut Attorney General agreed with the Department that Connecticut, as a matter of Federal constitutional law, could not impose a Connecticut tax on anything other than Connecticut real property and tangible personal property and intangible personal property owned by a Connecticut resident. Hence, Connecticut would not seek to impose in effect a Connecticut tax on the Florida portion of the estate, and that property would escape taxation at the state level.

The question of disparate taxes and rates was never raised, and the problem seemed largely theoretical as long as every taxing state used the same table and rates. In much the same way as the now defunct credit worked, the taxes were allocated among the states in proportion to the property located therein.

Beginning in three months, for anyone dealing with Connecticut, either from without or within, the problem has become quite real. The reasoning in the August 1, 2006 opinion ought to result in the windfall posited above inuring to the estate; otherwise, the domiciliary state will be imposing its tax on property over which it has no constitutional taxing jurisdiction. In practice, this seems to represent the general procedure.

Connecticut has never operated as a leader in tax reduction, and the notion that it would evolve into a tax haven, relatively speaking, probably boggles the mind of most experienced Connecticut trust and estate lawyers. Consequently, it seems unlikely that this comparative tax advantage will remain long-lived.

As other states adopt their own rates and exemptions, the existing crazy quilt of state taxation of estates appears headed for increased dysfunctionality. Whether Connecticut has inadvertently started the desirable process of pacing off the last mile of state taxation of estates remains to be seen. One can reasonably anticipate that the issues raised above will become more complex as, in all likelihood, more states compete by abandoning the old Section 2011 table in favor of greater freedom and creativity.

Connecticut achieved its breakthrough by increasing its income tax rates on individuals with incomes over \$500,000 and married couples with incomes over \$1 million. Governor Jody Rell wanted to repeal the estate tax. The legislature must have recognized that the state's growing dependence on the well-to-do entailed doing something to keep them around. Given the economic strains under which the states are currently laboring to balance their budgets, the odds that state legislatures will soon appreciate that they are driving out wealth and repeal their estate taxes still appear pretty long. But Connecticut may signal a beginning.

**HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!**

# Irving Schloss

# Elizabeth Leamon

**CITE AS:**

LISI Estate Planning Newsletter # 1540 (October 26, 2009) at <http://www.leimbergservices.com> Copyright 2009 Leimberg Information Services, Inc. (LISI). Reproduction in Any Form – or Forwarding to Any Person Prohibited – Without Express Permission.

**CITES:**

Connecticut Public Act 09-03 of the June Special Session; Conn. Gen. Stat. § 12-391; Formal Opinion 2006-018, Attorney General State of Connecticut; Del. Code Title 30, § 1501 *et seq.*; Mass. Gen. Laws ch. 65C § 2A ;N.J. Stat. § 54:38-1; N.Y. Tax Law § 952; R.I. Gen. Laws § 44-22-1.1.