

# Legislative Update

*August 2008*

## **FEDERAL ESTATE TAX UPDATE**

When revisions to the federal estate tax were passed in 2001 providing for an increase in the estate tax exemption to \$3.5 million in 2009, a repeal of the estate tax in 2010 and a \$1 million exemption in 2011, most practitioners thought Congress would revise this system long before we reached 2008. However, those revisions have not occurred, and as the law currently stands, the federal estate tax exemption will increase to \$3.5 million in 2009, and there will be no estate tax on estates of those dying in 2010. In 2011, the estate tax exemption will revert to \$1 million.

The current consensus is that Congress will act shortly after the presidential election to avoid the repeal of the estate tax in 2010. What form the estate tax will take – the exemption amount and rate of tax (the current rate is 45%) – is still the subject of speculation. However, we can report the positions the presidential candidates have expressed on the topic. Specifically, Senator John McCain supports an exemption of \$5 million per individual with an estate tax rate between 15% and 20%. Senator Barack Obama seems to support an exemption amount of \$3.5 million per person with a 45% rate.

Of course, there is no guarantee that Congress will act at the end of this year, or that the candidates' proposals will be enacted, so we remain in a wait-and-see mode. However, if no changes are made and the federal estate tax exemption increases to \$3.5 million, it will impact the Connecticut estate tax as explained further below.

### **IMPACT OF CONNECTICUT ESTATE TAX IN 2009**

As we have noted in prior client newsletters, Connecticut also revised its estate tax system in response to the federal estate tax changes discussed above. While the nature of the federal estate tax is still uncertain, we have reached a point where Connecticut's estate tax system and the federal system will diverge and may require revisions to clients' estate plans.

Prior to the 2001 legislation (known as EGTRRA), the federal estate tax provided a credit for state taxes paid by a Decedent's estate up to a maximum amount. Many states tied their estate tax system to this maximum credit amount (known as the "state death tax credit") thereby enabling states to obtain estate tax dollars without increasing the overall estate tax burden. EGTRRA reduced and then eliminated the state death tax credit resulting in the repeal of many state estate taxes, including Connecticut's estate tax.



States responded by revising their death taxes to ameliorate the impact of the federal changes on state revenues and “decoupled” from the federal estate tax by imposing an independent estate tax system. Connecticut followed this trend and reinstated the Connecticut estate tax with a \$2 million exemption and imposed a tax on transfers whether by gift during life, or at death, that exceed a combined \$2 million.

As a result of this decoupling, in 2009 Connecticut will have a \$2 million estate tax exemption while the federal estate tax exemption will be \$3.5 million. Contrary to what we had hoped, the Connecticut legislature did not increase Connecticut’s exemption to make it equal to the federal exemption during the most recent legislative session. While it is possible the legislature will do so next year, we wanted to bring the disparity to your attention because it may impact the estate plans of some married couples.\*



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Many estate plans for married couples are drafted to shelter the federal estate tax exemption of the first spouse to die and delay payment of estate tax until the death of the second spouse. The discrepancy between the federal and Connecticut exemption amounts means that some of those plans may result in a significant Connecticut estate tax upon the death of the first spouse for Connecticut residents.

There are several ways which we can revise your estate plan to avoid or reduce the payment of the Connecticut estate tax. There are also many situations where it may be better from a tax perspective to pay the tax at the first death. As in all areas of estate planning, the right approach to this issue and the necessity of revisions to your estate plan depend heavily on the facts of your individual situation.

\* This may also apply to partners in Connecticut civil unions in some situations.

## QUESTIONS OR ASSISTANCE?

If you have any questions about this legislative tax update, please contact one of the members of the Trusts and Estates Practice Group listed at left.

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