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2009 Estate Tax Changes = 2009 Estate Planning Changes

As of January 1, 2009, Connecticut residents face a new challenge when planning to avoid or defer estate taxes. For the first time since Connecticut adopted the estate tax system, the exemption for its estate tax is less than the exemption for the federal estate tax.

This has potentially adverse tax consequences for married couples who have utilized the federal estate tax exemption in their planning. In addition, this could have an impact on clients with real property located outside the State of Connecticut.

What Does This Mean?

Effective January 1, 2009, the exemption from federal estate taxes increased substantially to \$3.5 million. (Although this is meant to be just for this year, we expect Congress to freeze the exemption for a number of years at this amount.) The exemption for Connecticut estate taxes will remain at \$2 million. For the first time, there is a \$1.5 million gap in the exemptions (\$3.5 million reduced by \$2 million). Please note that the marital deduction remains in effect, so any amounts left to a spouse will be tax deductible.

The Connecticut estate tax is a “cliff tax.” What this means is that estates valued at \$2 million and below pay no estate tax. Once an estate exceeds \$2 million, the state captures the tax due on the first \$2 million, so

a taxable estate of \$2,000,001 must pay a Connecticut estate tax of \$101,600. From that point, the tax rates rise progressively as the size of the taxable estate increases, until they reach 16% for estates in excess of \$10.1 million.

Many married clients with estates in excess of \$2 million have taken advantage of the federal exemption amount by creating a

trust when the first spouse dies (the “credit shelter trust” or “bypass trust”.) This trust is created by a formula linked to the federal exemption. When the federal exemption increases, the documents will automatically raise the amount that funds this trust to \$3.5 million.

If no changes are made to the will and trust documents, there may be a

Connecticut estate tax imposed when the first spouse dies. If at the death of the first spouse, the credit shelter trust is fully funded with the federal exemption of \$3.5 million, there will be a Connecticut estate tax of \$229,200 at the death of the first spouse. Clearly, this is something that most couples will want to avoid. Now that the federal estate tax exemption is \$3.5 million but the Connecticut exemption remains at \$2 million, we need to shift our focus for many of our clients to reduce or eliminate the Connecticut estate tax.

For the first time since CT adopted the estate tax system, the state tax exemption is less than the federal estate tax. Now is the time to review your estate planning to assure that you avoid Connecticut estate taxes.

What can I do about the gap if I am married?

For our married clients with estates in excess of \$2 million, the planning to reduce or eliminate the Connecticut estate tax uses the credit shelter trust. We often advise the use of this trust, even if it is only used to avoid the Connecticut estate tax. For married clients with estates in excess of \$4 million, we now advise the creation of a new layer to that concept, a new trust which we call the "Connecticut Marital Trust."

What is the plan?

The plan begins by creating the credit shelter trust (sometimes known as the "Family Trust"). Traditionally, this trust can be used for the benefit of the spouse and the children or just the spouse. If we want to defer the Connecticut estate tax, we split this trust into two parts.

The first part can remain a traditional Family Trust and can be used during the lifetime of the surviving spouse for the benefit of the spouse or the spouse and the children, if so desired. This is capped at the amount of the Connecticut exemption available at the death of the spouse.

The second part is the Connecticut Marital Trust, a trust just for the benefit of the surviving spouse. This trust can qualify for the marital deduction for Connecticut estate tax purposes, so the estate is not taxed when the first spouse dies. This Connecticut Marital Trust is funded with the gap of \$1.5 million. (Please note that these amounts are adjusted if taxable gifts are made during your lifetime.) The estate tax on the Connecticut Marital Trust will be deferred until the surviving spouse dies. If the spouse moves out of state, it is questionable whether the trust will ever be subject to Connecticut estate tax.

Can same sex couples who are married use this strategy?

Please note that the federal marital deduction does not apply to gay partners who are married. However, we can utilize the Connecticut marital deduction to save Connecticut estate taxes. The above plan to split the credit shelter trust into two pieces is a strategy that can work for gay couples who are married.

Can I do anything about the gap if I am not married?

Unmarried clients can also plan to avoid the Connecticut estate tax. Traditional planning techniques such as gifting, using irrevocable life insurance trusts and other tools are available. Also, for clients who have more than one home, a change in domicile may be a way to avoid the Connecticut estate tax.

If you have real property outside the State of Connecticut, gifting techniques can help to reduce your estate tax burden.

Using the charitable deduction – a different approach

Making gifts to charities in your will is another strategy to eliminate the Connecticut estate tax if the net value of the estate is between \$2 million and \$2.1 million. A gift to charity to reduce the estate to below \$2 million is generally less than the amount of the Connecticut estate tax, so the family receives the same amount but the charity benefits. This may also be recommended for estates close to the exemption amount, to account for increased assets at death. There is a formula we can utilize to protect in this circumstance.

What about changes to the estate tax at the federal level?

We expect that Congress will freeze the federal exemption at \$3.5 million for the next few years, but it is very likely that there will be more changes to the federal estate tax in 2009. Depending on what those changes are, you may require further adjustments in addition to those described above. We will advise you if this is the case.



For more than half a century, Cohen and Wolf has represented businesses and individual clients in matters involving corporate law, securities arbitration and litigation, real estate, land use, tax, employment and labor, all types of litigation, municipal law, personal injury, family law, estate planning, elder law and asset protection planning. The firm's team of more than 50 experienced lawyers is based in its four Connecticut offices in Bridgeport, Danbury, Orange and Westport.

What should I do now?

Call us. If you have not reviewed your estate planning in the last couple of years, now would be a good time to do so. We can help you determine whether or not you and your family can benefit from changes to your plan.