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Estate Taxes: Survey & Update

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This presentation is for informational purposes only. It is not intended to provide, and should not be relied upon as, legal advice.

Agenda

1. Seminar Objective
2. Estate Tax
3. Who is Subject to Estate Tax?
4. Exclusions
5. Deductions
6. Rates
7. Filing
8. Payment
9. Estate Tax Liens
10. Gift Tax
11. Questions

Objective

To provide a brief overview of federal and
Connecticut estate taxes

Seemingly minor differences in the facts of a specific case may have a dramatic effect on tax liability. Time and venue issues require the scope of this presentation to be limited.

Note

- Connecticut's succession tax was eliminated beginning with estates of decedents who died on or after January 1, 2005
- Connecticut's GST tax laws are of no effect due to the elimination of the federal GST credit for state GST (effective 1/1/2005)

ESTATE TAX

Estate Tax

- Transfer tax at death
 - Levied on the privilege of the transfer, not on persons or property*
- Basis: entire net taxable estate
- Fair market value as of date of death

*Blodgett v. Bridgeport City Trust Co., 115 Conn. 127, 161 A. 83 (1932); Appeal of Silberman, 105 Conn. 192, 134 A. 778 (1926), *aff'd in part, rev'd in part on other grounds*, 277 U.S. 1, 48 S.Ct. 410, 72 L.Ed. 749, 8,8 A.F.T.R. (P-H) P 10243 (1928), *et seq*

Unified System

- Links estate and gift tax system
- Federal and Connecticut

In General...

- Estate tax criteria vary according to the year of death
 - Rate
 - Exclusions
- Connecticut estate tax is different from the federal estate tax

Federal Gross Estate

All property in which the decedent had an interest (including real property outside the United States)

Federal Gross Estate

- Lifetime transfers made without adequate and full consideration in money or money's worth
- Annuities
- The includible portion of joint estates with right of survivorship

Federal Gross Estate

- The includible portion of tenancies by the entirety
- Certain life insurance proceeds
- Property over which the decedent possessed a general power of appointment

Federal Gross Estate

- Dower or curtesy (or statutory estate) of the surviving spouse, and
- Community property to the extent of the decedent's interest as defined by applicable law

Connecticut Gross Estate

- Real property
- Tangible personal property
- Intangible personal property

Connecticut Gross Estate

Tangible personal property wherever located

- Antiques
- Art collections
- Automobiles
- Boats
- Clothing
- Coin collections
- Household furniture and furnishings
- Jewelry
- Stamp collections

Connecticut Gross Estate

Real property wherever located

- Home
- Rental
- Commercial
- Farm
- Vacant Land

Connecticut Gross Estate

Intangible personal property wherever located

- Bank Accounts
- Cash
- Stocks
- Bonds
- Pensions
- Copyrights
- Interest in Estates of other decedents

Connecticut Gross Estate

Intangible personal property wherever located

- Royalties
- Mortgages
- Notes
- Partnership Interests
- Remainder
- Interest in Trusts and Estates
- Unincorporated Businesses

Examples

In 2007, Becky transfers real property to her son Adam. The fair market value of the real property in 2007 is \$275,000. Adam pays Becky nothing for the property. This constitutes a gift of \$275,000 and will be includible in Becky's estate.

Example

At age 75, Mildred changes her solely-owned checking account to survivorship, naming her daughter Jennifer as the survivor. Upon Mildred's death, the full date of death value of the balance in the checking account will be includible in Mildred's estate for Connecticut and federal estate tax purposes.

Example

In 1999, Steve Morgan, a Connecticut resident, created the Morgan Family Living Trust. In 2005, Steve passes away. The entire value of the assets in the trust are includible for calculation of Steve's Connecticut and federal estate tax liability.

WHO IS SUBJECT TO ESTATE TAX

Federal

- United States citizens
- Certain resident aliens
- Reference: IRS Form 1040NR and instructions

Connecticut

- Connecticut residents
- Nonresidents of Connecticut who own taxable property in Connecticut when they die
 - Connecticut real property
 - Connecticut tangible personal property
- Nonresident of Connecticut for whom a full estate is opened under Conn. Gen. Stat. §45a 287 or 45a 303(a)(2)

Connecticut

Connecticut nondomiciliaries must file Form C-3 UGE, State of Connecticut Domicile Declaration

Calculation of Nonresident

- Calculate Connecticut estate tax as though nonresident were a Connecticut resident
- Multiply that amount by a fraction:

$$\frac{\text{Value of Connecticut property}}{\text{Value of gross estate}}$$

EXCLUSIONS

Lifetime Exclusions

Also known as:

- Exemptions
- Unified Credit

Estate Tax Exclusions

Year	Connecticut	Federal
2018	\$2.6 million	\$11.2 million
2017	\$2.0 million	\$5.49 million
2016	\$2.0 million	\$5.45 million
2015	\$2.0 million	\$5.43 million
2014	\$2.0 million	\$5.34 million
2013	\$2.0 million	\$5.25 million
2012	\$2.0 million	\$5.12 million
2011	\$2.0 million	\$5.0 million

Portability

- Federal only
- Beginning January 1, 2011, estates of decedents survived by a spouse may elect to pass any of the decedent's unused exclusion to the surviving spouse. This election is made on a timely filed estate tax return for the decedent with a surviving spouse

Lifetime Exclusions: A Comparison

	Connecticut	Federal
Unlimited between spouses		
2017	\$2 million	\$5.49 million
Indexed to inflation		
Portable between spouses		

Connecticut Estate & Gift Tax Changes

Lifetime Exclusions

- 2011-2017: \$2.0 MM
- 2018: \$2.6 MM
- 2019: \$3.6 MM
- 2020: Equal to federal exclusion

DEDUCTIONS

Connecticut Taxable Estate^{*}

- The decedent's gross estate, as valued for federal estate tax purposes; **less**
- Allowable federal estate tax deductions, as determined under Chapter 11 of the Internal Revenue Code (IRC); **plus**
- The aggregate amount of all Connecticut taxable gifts made by the decedent, during his or her lifetime, during all calendar years beginning on or after January 1, 2005, other than Connecticut taxable gifts that are includable in the decedent's federal gross estate; **plus**
- The amount of any gift tax paid to this state by the decedent or the decedent's estate on any gift made by the decedent or decedent's spouse during the three-year period preceding the date of the decedent's death.

^{*}http://www.ct.gov/drs/lib/drs/forms/1-2017/estate-gifttax/ct-706_nt_instructions.pdf accessed 10/19/17

Estate Tax Deductions

- Allowable estate tax deductions as computed for federal estate tax purposes (other than the deductions allowable for state death taxes under IRC §2058)
- Funeral expenses and expenses incurred in administering property subject to claims
- Debts of the decedent
- Mortgages and liens
- Net losses during administration
- Expenses incurred in administering property not subject to claims
- Bequests, etc., to surviving spouse
- Charitable, public, and similar gifts and bequests

However...

- Connecticut DRS holds the view that it retains authority to challenge federal determinations
 - Fractional interest discount for real property
 - Business interest valuation
 - IRS allowed deductions for costs of sale of estate property

Gifts

- Federal: net taxable gifts since 1977 added to net taxable estate
- Connecticut: net taxable gifts since 2005 added to net taxable estate

RATES

Federal

40% (2012-2018)*

* Pub. L. No. 111-312 Stat: 3296

Table A — Unified Rate Schedule

Column A Taxable amount over	Column B Taxable amount not over	Column C Tax on amount in Column A	Column D Rate of tax on excess over amount in Column A
\$0	\$10,000	\$0	18%
10,000	20,000	1,800	20%
20,000	40,000	3,800	22%
40,000	60,000	8,200	24%
60,000	80,000	13,000	26%
80,000	100,000	18,200	28%
100,000	150,000	23,800	30%
150,000	250,000	38,800	32%
250,000	500,000	70,800	34%
500,000	750,000	155,800	37%
750,000	1,000,000	248,300	39%
1,000,000	-----	345,800	40%

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**Table of
Basic Exclusion Amounts**

Period	Basic Exclusion Amount	Credit Equivalent at 2017 rates
2014	\$5,340,000	\$2,081,800
2015	\$5,430,000	\$2,117,800
2016	\$5,450,000	\$2,125,800
2017	\$5,490,000	\$2,141,800

*2010 Federal Rate

- Temporary “repeal” of the federal estate tax for decedents dying in 2010
- 2010 Tax Act: Federal estate tax was retroactively set at a maximum rate of 35%, increased exemptions to \$5.0 million, and unified the gift tax and estate tax to allow utilization of entire \$5.0 MM during lifetime or at death
- For decedents dying in 2010, the estate had the option of electing out of the federal estate tax or electing in
- Step-up in carryover basis was eliminated for those estates that elected out of the federal estate tax in 2010

Connecticut Estate Tax Rate Changes

- Marginal rates increased
 - \$5.1 MM to \$10.1 MM
 - No increases for amounts above or below that range
- Maximum tax imposed currently \$20 MM; to be reduced to \$15 MM in 2019

<i>Value of Taxable Estate or Gift</i>	<i>Marginal Rates</i>			
	<i>Current Law</i>	<i>Bill</i>		
		<i>2018</i>	<i>2019</i>	<i>2020 and after</i>
Up to \$2,000,000	None	None	None	None
\$2,000,001 to \$2,600,000	7.2%			
\$2,600,001 to \$3,600,000		7.2%		
\$3,600,001 to \$4,100,000	7.8%	7.8%	7.8%	
\$4,100,001 to \$5,100,000	8.4%	8.4%	8.4%	

<i>Value of Taxable Estate or Gift</i>	<i>Marginal Rates</i>			
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<i>\$5,100,001 to federal threshold</i>	<i>9.0%</i>	<i>10.0%</i>	<i>10.0%</i>	
<i>Federal threshold to \$6,100,000</i>				<i>10%</i>
<i>\$6,100,001 to \$7,100,000</i>	<i>9.6%</i>	<i>10.4%</i>	<i>10.4%</i>	<i>10.4%</i>
<i>\$7,100,001 to \$8,100,000</i>	<i>10.2%</i>	<i>10.8%</i>	<i>10.8%</i>	<i>10.8%</i>
<i>\$8,100,001 to \$9,100,000</i>	<i>10.8%</i>	<i>11.2%</i>	<i>11.2%</i>	<i>11.2%</i>
<i>\$9,100,001 to \$10,100,000</i>	<i>11.4%</i>	<i>11.6%</i>	<i>11.6%</i>	<i>11.6%</i>
<i>Over \$10,100,000</i>	<i>12%</i>	<i>12%</i>	<i>12%</i>	<i>12%</i> 48

FILING

Federal

- IRS Form 706
 - 9 months after date of death
 - 6 month extension may be granted
- Executor is personally responsible for payment, but is discharged upon written application to the Commissioner for determination of the tax and upon its payment
- Filing not necessary in nontaxable estates
 - Exception: nontaxable estates where portability is elected

Connecticut

- Amended returns
- Gift splitting

Connecticut

- QTIP Election
- Permitted solely for Connecticut estate tax purposes
- May only be made if no election was made for federal estate tax purposes under IRC §2056(b)(7) to treat a trust or other property of the decedent's gross estate as QTIP
 - Must file CT-706/709, not CT-706 NT

Retained Life Estate

- Created when the decedent transferred property before death but retained or is deemed to have retained an interest for their life
- Includable in the gross estate at full value
- Federal and Connecticut

Federal Estate Tax Summary

1. Value of all assets in which decedent had an interest as of the date of death
2. Subtract allowable deductions and reductions in asset value
3. Add in value of qualified lifetime gifts
4. Computation of tax
5. Subtract available unified credit

Connecticut Estate Tax Summary

1. Federal gross estate
2. Subtract allowable deductions and reductions in asset value
3. Add in value of lifetime Connecticut taxable gifts
4. Subtract real and tangible property located outside of Connecticut
5. Computation of tax
6. Subtract available unified credit

PAYMENT

Payment

- Subject to proration among beneficiaries/heirs
- Unless provided otherwise in decedent's will, the equitable contribution of each beneficiary will be in proportion to the amount of taxable property passing to that beneficiary

ESTATE TAX LIENS

Connecticut Estate Tax Liens

- Unrecorded lien on Connecticut real property
- Released upon Probate Court or DRS determination that:
 - no tax is due, or
 - payment of the estate tax with respect to the interest of the decedent in such property is adequately insured

Example

Jack and Mary Magilicutty, husband and wife, are Connecticut residents. They own their home in Fairfield in survivorship with each other. All their assets are either in survivorship, have beneficiary designations, or have TOD/POD designations. The total value of all their assets is \$1.24 MM. In 2014, Jack dies. Mary, believing that all Jack's assets, including the house, pass to her without probate court intervention, does not file a Connecticut estate tax return with the Probate Court.

In 2016, Mary decides that her house is too large for one person, and enters into a contract to sell it to Jennifer Buyer. One week before the scheduled closing on the house, counsel for Buyer contacts Mary's attorney informing her that the transaction cannot take place because of liens for Connecticut estate tax and probate fees.

Federal Estate Tax Liens

- IRC § 6324(a)
- Automatically created when any resident of the United States dies
- Attaches to assets of the gross estate required to be reported on form 706
- Lien follows a probate asset
- Non-probate asset: liability equal to the value of the asset at the time of the decedent's death becomes due from the transferee

Federal Tax Liens (cont'd)

Assets of the gross estate can be sold or encumbered free of the IRC § 6324(a) lien if the proceeds from the sale or loan are used for the payment of charges against the estate or expenses of its administration that are allowed by any court having jurisdiction

Federal Tax Liens (cont'd)

- June 2016, IRS imposed additional requirements to issue Release of Lien
 - Net proceeds of sale to paid over to IRS, or
 - Estate enter into escrow agreement
 - Escrow agent holds funds until completion of IRS audit process of 706
- Interim guidance April 5, 2017: Memorandum SBSE-05-0417-0011
 - Clarifies the process to obtain a Release of Lien

GIFT TAX

Gift Tax

Transfer of property by one individual to another while receiving nothing, or less than full value, in return. The tax applies whether the donor intends the transfer to be a gift or not.

Connecticut

- All gifts by Connecticut residents
 - Defined as transfers by gift that are included as taxable gifts for purposes of United States gift tax made on and after 1/1/2005
- Exceptions:
 - Out of state real property
 - Out of state tangible personal property
- Gifts by nonresidents of:
 - Connecticut real property
 - Connecticut tangible personal property

Connecticut (cont'd)

- Federal deductions under IRC §§ 2522 and 2524 are allowed
 - Includes annual exclusion for gifts of present interest in property (\$15,000 in 2018)
 - Charitable deductions
 - Unlimited marital deduction for U.S. citizen spouses

Connecticut (cont'd)

- Other nontaxable gifts:
 - Direct payment of:
 - Tuition ¹
 - Medical expenses ¹
 - Certain payments made in conjunction with dissolution of marriage ²
 - Qualified disclaimers ³

1. U.S.C.A. §2503(e)

2. U.S.C.A. §2516

3. U.S.C.A. §2518

Annual Exclusions

- Connecticut & federal
- 2018: \$15,000 per donor per donee
- Amount may change as frequently as annually

Deductions

- Gift to spouse (spouse must be a U.S. citizen)
- Gift to charity

Valuation

- Fair market value as of date of gift
- Caveat – if donor retains an interest in a gift to a family member, special valuation rules may apply
 - For example, the value of the retained interest may not be deducted from the fair market value of the gift for gift tax calculation purposes

Rates

2016 Federal Gift Tax Rate Table

Column A	Column B	Column C	Column D
Taxable amount over	Taxable amount not over—	Tax on amount in Column A	Rate of tax on excess over amount in Column A
-----	\$10,000	-----	18%
\$10,000	20,000	\$1,800	20%
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40,000	60,000	8,200	24%
60,000	80,000	13,000	26%
80,000	100,000	18,200	28%
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<i>Over \$10,100,000</i>	<i>12%</i>	<i>12%</i>	<i>12%</i>	<i>12%</i> ⁷⁶

Requirements

- Donor must be competent to make a gift
- Donee is capable of receiving and possessing gift
- Donor has donative intent
- Actual or constructive delivery of the asset to the donee or donee's representative
- Acceptance of the gift by the donee

Example

Decedent died February 22, 1982. Prior to his death, he instructed his son, who had a general power of attorney over the decedent's assets, to make a gift of \$10K to each of his children. Decedent's son wrote checks to himself and his siblings against his father's checking account. Several of these checks were cashed prior to decedent's death, others were cashed after his death.

Example (cont'd)

In addition, decedent's son instructed decedent's brokerage firm to sell some of decedent's securities and issue checks to each of decedent's children and their spouses. Again, several of these checks were cashed before decedent's death, others were not. On the estate tax return, all of these transfers were excluded from the decedent's gross estate under the theory that they were completed gifts within the annual exclusion. IRS contended that the transfers were includable in the gross estate.

Example (cont'd)

The estate appealed the IRS determination to Tax Court.

Held:

- For IRS relative to those checks from the decedent's checking account that were not cashed before the decedent's death
- Brokerage firm checks are excludable if, under local law, these checks constituted completed gifts
- Court found that brokerage firm was agent of decedent; agency terminated upon decedent's death
- Brokerage checks issued after decedent's death were improperly excluded from decedent's gross estate
- Brokerage checks removed from decedent's account at the time the checks were issued were analogous to cashier's checks or certified checks and were properly excluded from gross estate

Example¹

During calendar year 2014, Mary conveys title to her house to her three children and either retains a life use for herself on the deed or does not retain a life use for herself on the deed but continues to occupy the residence. Mary does not receive any money or other type of consideration for the house from her children. Mary has made a gift of a future interest to her children. Because this is a gift of a future interest to her lineal descendants, it is subject to the special valuation rules (IRC §§2702 et seq.). The value of Mary's gift determined under the special valuation rules is the property's fair market value (less encumbrances). Because this is a gift of a future interest, annual exclusions do not apply.

1. 2014 Form CT-706/709 Connecticut Estate and Gift Tax Return and Instructions. <http://www.ct.gov/drs/lib/drs/forms/2014forms/estateandgifttax/2014-ct-706-709-booklet.pdf> accessed 10/13/14
2. IRC Section 2702: <https://www.law.cornell.edu/uscode/text/26/2702>

QUESTIONS

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