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Report From Counsel

Insights and Developments in the Law

Summer 2006

Update: Connecticut Gift and Estate Tax Law

By Guy R. DeFrances

In June of 2005, the Connecticut General Assembly enacted a new Connecticut estate tax, substantially revised the Connecticut gift tax, and combined the two into a unified system of lifetime and death taxation. Below are some highlights of the new law, which was retroactive to January 1, 2005:

- The estate tax applies to estates in which the Connecticut taxable estate exceeds \$2 million, and it is imposed upon Connecticut residents and also upon nonresidents who own real property in Connecticut on the date of death.
- Like the federal estate tax, there is an unlimited deduction for assets passing to the surviving spouse.
- While there is an exemption of \$2 million, if a decedent's taxable estate exceeds the \$2 million, then the tax is imposed on the entire estate with no offset for the exemption.
- The gift tax applies to all gifts made after January 1, 2005 above the annual exclusion for present interest gifts (now at \$12,000 per year per donee). However, the tax is not imposed until the lifetime total of those gifts exceeds \$2 million.
- At death all taxable gifts are brought back into the estate and added to estate assets to arrive at the Connecticut taxable estate.
- The Connecticut succession tax has been repealed.

For the most part, the Connecticut Gift and Estate Tax Law follows federal law with respect to determining the value of property and allowable deductions, but Connecticut has its own set of rules with respect to exemptions and rates of tax. The new law has created new filing requirements: (a) all estates below the \$2,000,000 exemption must now file a CT706-NT return with the Probate Court; and (b) those estates that are taxable must file a CT706/709 form with the Probate Court and the Department of Revenue Services of the State of Connecticut. Annual gifts in excess of the annual exclusion are reported on the CT706/709 to the Department of Revenue Services by April 15 of the year following the gifts. Life insurance must now be reported on both the CT706 NT and the CT706/709.

The rates begin at 5.085% on estates that exceed the \$2,000,000 exemption and increase to 16% on estates that exceed \$10,100,000. The Connecticut tax as finally determined is deductible against the federal estate tax in the decedent's estate. Below is an example of the Connecticut tax calculation for a taxable estate of \$3,100,000 under the new Connecticut law:

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Experience Counts!

Every so often we are all reminded of the value of experience. Attorney Dennis F. Gaffney, an experienced trial attorney for over 40 years and a partner at Luby Olson, P.C., recently received an offer from an insurance company to settle a case for \$7,500. Our client rejected the offer. After Attorney Gaffney presented the case to the jury, the insurance company raised its offer to \$25,000. After consulting with Attorney Gaffney, our client rejected that offer.

Then the jury came down with its long awaited verdict. What was the award? \$213,500! So does experience count? *You bet it does!* Chalk up another one, Attorney Gaffney!

Important Medicaid Update on Page Three

A FULL SERVICE LAW FIRM

Personal Injury • Automobile Accidents • Negligence • Malpractice • Business and Corporations
Probate and Wills • Commercial and Residential Real Estate • Divorce • Medicaid (Title XIX) • Other Areas

Should You Incorporate Your Business?

Following fast on the heels of a decision to go into a particular kind of business is the decision about what kind of legal form it should take. The most common options are a sole proprietorship, a partnership, or a corporation. You may lean toward the corporate route because you like the sound of having “Inc.” after the company’s name, but there are some more practical, business-like considerations to take into account.

More so than with some of the other structures for a business, starting a corporation means complying with formalities required by state laws. Once the shareholders (owners) of the business agree on some basic matters, such items are embodied in articles of incorporation that must be filed with the appropriate state agency. These essentials usually include:

- a corporate name;
- the number of shares that can be issued;
- the number of shares each owner will buy and for what contribution of cash or property;
- the nature of the corporation’s business; and
- the identity of the directors and officers of the corporation who will handle day-to-day operations.

The fledgling corporation will also need bylaws, which constitute a procedural rule book for the company.

Decisionmaking

The bottom line here is that whoever holds a majority of the shares of a corporation has ultimate control over it. Usually it takes a majority of the shares to elect the board of directors, which is charged with making the “big picture” decisions. If a decision is momentous enough for the company’s future, such as a change in the articles of incorporation or whether or not to merge with another company, the shareholders usually have a more direct role in that they themselves must approve the decision by a certain margin of votes.

The board elects the officers of the

corporation, typically including a president, vice-president, secretary, and treasurer. The officers may or may not be salaried employees or shareholders, and in some cases one person may hold more than one office.

Accountability

At or near the top of the list of characteristics favoring the corporate structure is the fact that, since the corporation is treated as a legal “person” separate from the people who own and run it, the

shareholders as a rule are not personally liable for the corporation’s debts. Instead, their risk is confined to their investment in the company. To every rule there is an exception, however, and here the exception has the colorful legal name of “piercing the corporate veil.” If the owners do not comply with the statutory requirements for running a corporation, or if they blur the lines too much between corporate and personal

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Eminent Domain Update

Landowner Loses the Battle but Wins the War

In one of the most controversial eminent domain decisions ever, the United States Supreme Court ruled in 2005 that a city’s exercise of its eminent domain powers to take private property in furtherance of an economic development plan satisfied the constitutional requirement that such power be used only for a “public use,” even though private developers stood to profit handsomely from the city’s actions. In reaction to that ruling, some state legislatures have been busy crafting legislation to limit the use of condemnation powers in such circumstances. For their part, the owners of property targeted for condemnation have considered how they still might fend off the taking, or, failing that, how to maximize the compensation that the government must pay.

In a recent case, a landowner was not able to defeat a condemnation initiated by a city so that a new hotel could be built on the property, but he did receive maximum compensation from an obviously sympathetic jury. The landowner was an immigrant who had spent two years and a lot of money renovating a warehouse and building a

mail-order cigar business. When two private developers were unsuccessful in negotiations to buy the property as a site for a hotel, they instead reached an agreement with the city whereby the city would condemn the property for their desired use and the developers would pay the costs and fees associated with the condemnation.

When the city was first attempting to buy the property, it sent the landowner a toxic waste notice requiring him to investigate whether any toxins existed in the ground. The landowner tried to comply, but after spending many thousands of dollars he found no toxins. The city would later admit in the litigation that such an investigation was not really feasible so long as a building remained on the property. The toxic waste notice, and especially its suspicious timing, came to be seen as a tactic to put pressure on the landowner during the negotiations leading up to the condemnation.

Although the trial court ruled that the city could condemn the land for the hotel, in the subsequent trial before a jury for damages, the landowner fared much better. The jury awarded him the

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Medicaid Law Update (Title XIX)

By Kenneth W. Mango

In our last issue, I discussed the passage of the Deficit Reduction Act of 2005 (DRA), which dramatically changed the Medicaid law. Medicaid applicants now have a five (5) year “look-back” period rather than a three (3) year period. In addition, the penalty period for gifts made within the five (5) year “look-back” period now commences on the date that one applies for Medicaid, i.e., at the time the applicant’s assets are depleted, rather than on the date the gift was made.

The constitutionality of the DRA has now been challenged by two (2) federal lawsuits for the most unlikely of reasons not even related to Medicaid. Apparently, the Senate passed a different version of the DRA than the House of Representatives did! More specifically, Medicare has always paid for the rental of items such as oxygen equipment used in the home. However, in the Senate version of the bill, payment for oxygen equipment was capped at 36 months. In addition, the Senate version capped payments for “other equipment” rented by Medicare beneficiaries at 13 months. However, when the Senate sent the bill to the House after passage, the 36 month limit for oxygen tanks was instead inserted into the section regarding “other equipment,” so that the 36 months has now replaced 13 months for “other equipment.” This version (different from the Senate version) passed the House. The Senate clerk discovered and corrected the error but the House never voted on it again.

The error is a two billion dollar mistake. The Washington Post, in an April 1, 2006 editorial, says the DRA is not a valid law. If the lawsuits bear that out and the law declared unconsti-

tutional, we will be back to the old law until Congress takes further action. Given the controversy surrounding the DRA, Congress may not want to vote on the DRA again, in which case the old law will now become the current law. Confused? Probably not so much as the lawyers and judges who work in this area of the law. Stay tuned!

Editor’s note: Attorney Mango, Managing Partner of Luby Olson, P.C., is a member of the Elder Law Section of the Connecticut Bar Association.

To Incorporate or Not

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finances, the legal fiction of the corporation as a separate entity is ignored and the owners are on the hook for the corporation’s losses.

Transitions

As a separate entity in the eyes of the law, a corporation does not go out of existence if one or more of its owners dies. Instead, a corporation stays alive until its owners decide otherwise. Transfer of the ownership of the corporation is accomplished by selling its stock. New owners are added either when existing owners sell some of their stock or the corporation itself sells more shares of stock. The smaller the enterprise, the more likely it is that the owners, for whom the corporation may be both their property and their employer, may agree to restrict the sale

Eminent Domain

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entire amount he had sought. The award included several million dollars each for the value of the property itself and for the loss of the goodwill associated with the cigar business. Damages for loss of a business are not typical in condemnation cases, but the landowner was able to show that there was no suitable alternative location for the business, so that he would have to start over from scratch. For good measure, the jury also awarded damages equal to the cost of the dubious toxicity study that the landowner had been forced to undertake.

of the stock in order to maintain control.

The particular circumstances of each new business and the differences in the governing laws of the states make generalities difficult. That said, the factors on the debit side of the ledger for corporations include the costs of setting up the corporate entity, the need for a separate tax return, and the burden of “double taxation.” Double taxation means that the corporation is taxed on its profits, and the shareholders are then taxed on their dividends. On the credit side are limited liability for the owners and easy transfer of ownership.

Making the appropriate choice for a business form is one of the first, and one of the most important, decisions a new business will make. Whether choosing a corporate structure or some other form, make sure to consult with a qualified attorney.

Actual resolution of legal issues depends upon many factors, including variations of facts and state laws. This newsletter is not intended to provide legal advice on specific subjects, but rather to provide insight into legal developments and issues. The reader should always consult with legal counsel before taking action on matters covered by this newsletter.

Sports Injuries

Lightning Strikes Golfer

Patrick and his friend Christopher decided to get in some late-afternoon golf on a summer day that had seen periods of turbulent weather, but also some clear skies. As Christopher held the flag for Patrick to putt, a golf course employee sounded a horn to warn of lightning in the area. Patrick putted out to finish the hole. Then the two friends started walking back to the clubhouse, which was about a quarter of a mile away. On their way, they were struck by lightning. Christopher was rendered unconscious for a few moments, but Patrick suffered serious injuries, and he now needs total care.

A negligence suit by Patrick's parents against the golf course owner was unsuccessful. For an owner of property to be liable for injuries to someone on the property, the injury must have been foreseeable. Without that, no duty of care arises in favor of the injured person. Practically everyone knows that lightning is dangerous, but that is quite different from being able to foresee that a particular lightning strike may occur.

Even assuming that the golf course operators owed a duty to Patrick, they did not breach that duty. Patrick and Christopher were given notice that lightning was in the vicinity by means of the horn, which sounded about 10 minutes before the strike that injured Patrick. That would have been enough time to get back to the clubhouse had the boys immediately heeded the warning. Aside from the specific audible warning, a prominent sign at the course warned all golfers that they were playing at their own risk and that when lightning was in the area they were to return to the clubhouse.

The sobering lessons from this case are that golfers themselves bear the most responsibility for protecting themselves from lightning, and that to delay in seeking shelter when lightning is near is to risk a tragic outcome.

Gift and Estate Tax Law Update

Continued from page one.

Decedent's Estate	\$2,500,000
Plus Prior Taxable Gifts	+ 800,000
Gross Estate	\$3,300,000
Less Allowable Deductions	- 200,000
CT Taxable Estate	\$3,100,000
CT Tax	\$ 190,800

Planning Considerations

In all situations where the estates of the husband and wife exceed \$2,000,000, it is important to undertake marital deduction planning as has been historically done under the federal estate tax laws. The Connecticut estate tax, however, complicates marital deduction planning in that in the year 2009 the federal estate tax exemption will increase from \$2,000,000 to \$3,500,000 while the Connecticut estate tax exemption as presently written will remain at \$2,000,000. For example, if a decedent has an estate of \$4,000,000, dies in 2009, and his/her will passes an amount equal to the federal exemption to a credit shelter trust in order to minimize taxes upon the spouse's subsequent death, Connecticut will tax the entire \$3,500,000 because it does not pass to the surviving spouse. Proper planning can mitigate this result. However, for optimum results, planning must be undertaken while both spouses are living. Persons who presently have a two trust plan, i.e. a marital deduction trust and a credit shelter/family trust, should undertake a review of those documents in order to plan properly for both the federal and Connecticut taxes.

For those estates that include out-of-state property, the Connecticut estate tax provides for a credit for any taxes paid on real or tangible personal property that is located outside of Connecticut and is subject to taxes in that jurisdiction. Thus, a Connecticut decedent with real property in South Carolina would receive a credit for any death tax paid to the State of South Carolina. The difficulty in this situation is that many Connecticut residents have property in Florida, and Florida does not impose a death tax. Thus, the law as presently written would not provide any such credit, and in effect Connecticut would be taxing Florida property. It is anticipated that this result will not withstand a constitutional test and will be addressed by a future session of the legislature or the courts.

The issue of domicile can become important under the new Connecticut Estate Tax Law. Very often a decedent will have had contacts with Connecticut and some other states - most notably Florida, which has no death tax. Often the executor of that decedent's estate will try to establish that the decedent was a Florida resident. If successful, this effort would avoid Connecticut estate taxes, except that real property owned by the decedent in Connecticut would still be subject to the tax. However, the question of domicile is a factual one that would be determined by the particular circumstances.

Finally, in those estates that exceed \$2,000,000, the Connecticut estate tax presents additional complications. Careful planning is required to optimize the death tax situation at both the state and federal levels.

Editor's note: Attorney DeFrances, Partner of Luby Olson, P.C., is a Member of the Executive Committee of the Estates and Probate Section of The Connecticut Bar Association.