

IRS Issues Proposed Regulations Alleviating "Clawback" Concerns

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On Dec. 22, 2017, President Trump signed the Tax Cuts and Jobs Act (the 2017 Act) into law. The 2017 Act roughly doubled the estate, gift, and generation-skipping transfer (GST) tax exemption amounts from \$5.49 million per person in 2017 (or \$10.98 million per married couple) to \$11.18 million per person (or \$22.36 million per married couple) in 2018. In 2019, these exemption amounts will be adjusted for inflation to \$11.4 million per person (or \$22.8 million per married couple). The increased exemption amounts are set to expire on Dec. 31, 2025. Subject to certain exceptions, gifts, estates, and GST transfers in excess of the exemption amounts will continue to be taxed at a 40 percent rate.

IRS Proposed Regulations

Although the 2017 Act created an eight-year window of opportunity for lifetime gifting with the increased exemptions, some practitioners were concerned that such gifts could be "clawed back" upon a taxpayer's death. In effect, taxpayers who die after 2025 could retroactively be denied the full benefit of the higher exemption amount applied to previous gifts. For example, if an unmarried taxpayer made an \$11 million gift in 2019, fully sheltered by the taxpayer's gift tax exemption, but died in 2026 when the estate tax exemption amount was only \$5 million, would the excess \$6 million be subject to estate tax at the taxpayer's death? Even worse, could the excess be subject to gift tax during the taxpayer's lifetime if the gift tax exemption amount later decreased?

Thankfully, on Nov. 20, 2018, the Internal Revenue Service (IRS) issued proposed regulations (the "Proposed Regulations") that effectively eliminate the clawback concern. Under the Proposed Regulations, in the example from the previous paragraph, the taxpayer's excess gift would not be subject to estate tax at the taxpayer's death nor would it be subject to gift tax when the exemption amounts decreased in 2026.

The Proposed Regulations indicate that taxpayers must use the increased exemption amounts between now and 2025, or lose them. Consider, for example, an unmarried taxpayer who makes taxable gifts of \$4 million in 2019 and does not make any additional taxable gifts until 2026. If the exemption amounts decrease to \$5 million in 2026, the taxpayer's remaining exemption will be \$1 million. By contrast, if the same taxpayer makes an \$8 million gift in 2019, the \$3 million in excess of the \$5 million exemption amount will not be clawed back in 2026.

Estate Planning Implications

It is important to remember that the increased exemption amounts are set to expire in 2026, and could be reduced or eliminated prior to 2026 in a different political climate. With the Proposed Regulations eliminating the clawback concern, clients who have been considering substantial lifetime gifts should have more certainty in proceeding. This includes high-net-worth clients with taxable estates along with clients who may have already utilized substantially all of their exemptions in prior years. Traditional wealth-shifting strategies, such as installment sales to grantor trusts, grantor retained annuity trusts (GRATs), and leveraging exemptions through the use of valuation discounts, should continue to be attractive estate planning strategies.

Conclusion

While we hope that this information is helpful in understanding the estate planning implications of the Proposed Regulations, please note this is only a summary and does not address all details or contingencies. We welcome the opportunity to visit with you further regarding estate planning under the 2017 Act, and hope that you will call us with any questions.

Wealth Preservation Contacts

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