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No Clawback – A Holiday Gift From The IRS

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The following article was featured in the December 2018 edition of *Legacy*, the Vorys newsletter focused on wealth planning.

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In the 2017 Tax Act, the “basic exclusion amount” was doubled from \$5,000,000 to \$10,000,000. After taking into account inflationary adjustments since the \$5,000,000 amount was enacted, the effective basic exclusion amount became \$11,180,000 in 2018 (and it will become \$11,400,000 in 2019). This basic exclusion amount represents the amount that every individual can transfer free of gift tax during his or her lifetime or free of estate tax at his or her death to any individual he or she desires.

Unfortunately, the 2017 Tax Act also provided that the increase in the basic exclusion amount “sunsets” on January 1, 2026. This means that the basic exclusion amount will then revert to \$5,000,000 (plus inflationary adjustments).

In light of this “sunsetting” of the basic exclusion amount, the question arises as to what happens if an individual makes a gift of, say, \$9,000,000 in 2020, which would be fully covered by the basic exclusion amount, but then dies in 2026 after the basic exclusion amount has returned to \$5,000,000 (plus inflationary adjustments). Is the benefit of the higher basic exclusion amount in effect at the time of the gift lost?

The answer to this question was foreshadowed in the 2017 Tax Act, which instructed the Treasury Department to issue Regulations on the matter. On November 27, 2018, the Treasury Department issued Proposed Regulations clarifying that, if a gift is made prior to sunset that exceeds the \$5,000,000 basic exclusion amount, the basic exclusion amount applicable at death will be the basic exclusion amount that was actually used in computing the tax on the gift at the time of the gift. In other words, individuals can safely rely on the increased basic exclusion amount in making gifts prior to 2026, and the IRS will not attempt to “clawback” the tax on the prior gift when such individual’s estate tax return is filed following his or her death.

The issuance of the Proposed Regulations means that individuals who have estates that are likely to exceed the \$5,000,000 basic exclusion amount will want to consider making significant gifts prior to January 1, 2026 in order to lock in the basic exclusion amount prior to its sunset. Potentially, a classic case of “use it or lose it.” Unfortunately, however, based on the Proposed Regulations, a gift of \$5,000,000 (plus inflationary adjustments) will not use any portion of the increase in the basic exclusion amount. Therefore, at this time, only gifts which exceed \$5,000,000 (plus inflationary adjustments) will actually use and “lock in” the increase in the basic exclusion amount, and only to the extent that the gift actually exceeds \$5,000,000 (plus inflationary adjustments). Although the Proposed Regulations provide clarity on an important point, this clarity will leave many individuals with a difficult estate planning decision.

Please contact your Vorys attorney to discuss your individual situation and the potential strategies available to you.