

Increased Estate/Gift Tax Exemptions Under TCJA: No-Clawback, but Use it or Lose It



Christopher Rogers
crogers@mwlaw.com
(479) 464.5651

02/11/2019

The Tax Cuts and Jobs Act (“TCJA”) passed in December, 2017, doubled the estate and gift tax basic exclusion amount from \$5.0 million to \$10.0, coupled with a cost of living adjustment. For 2019, the basic exclusion amount is \$11.4 million.

Unless extended, the increased basic exclusion amount sunsets on December 31, 2025, and the estate and gift tax exemption returns to \$5.0 million, as then reflected by the cost of living adjustment.

We saw somewhat similar legislation in 2001 under the Economic Growth and Tax Reconciliation Act of 2001 (“EGTRA”, the George Bush tax cuts), where the exclusion amount was increased for 10 years, then sunset to pre-legislation numbers. A significant difference between the two Acts is that under EGTRA a person had to die to take advantage of the increased exclusion amount as it was bumped up from year to year; the increased exclusion amount was specifically not available to offset taxable gifts. The increase in the basic exclusion amount under the TCJA is an increase in both the estate and gift tax exclusion.

The Clawback

Although the TCJA specifically authorizes use of the increased exclusion amount to offset gifts, there was some concern that the IRS might interpret the act in a way that would limit its application to taxable gifts only if the decedent dies prior to December 31, 2025, via a clawback of the gifts due to the manner estate taxes are calculated. If the estate tax calculation is made with the clawback effect, then only taxpayers that die after December 31, 2017 and before January 1, 2026, would get the benefit of the increased exclusion amount.

The Treasury Department issued Proposed Regulation 20.2010-1(c) on November 20, 2018 to address the clawback issue, which provides that:

“Changes in the basic exclusion amount that occur between the date of a donor’s gift and the date of the donors’ death may cause the basic exclusion amount on the date of a gift to exceed that allowable on the date of death. If the total of the amounts allowable as a credit in computing the gift tax payable on the decedent’s post-1976 gifts ... exceeds the credit allowable within the meaning of section 2010(c) in computing the estate tax ... then the portion of the credit allowable in computing the estate tax on the decedent’s taxable estate that is attributable to the basic exclusion amount is the sum of the amounts attributable to the basic exclusion amount allowable as a credit in computing the gift tax payable on the decedent’s post-1976 gifts.”

In English ... a decedent can claim as his/her basic exclusion amount the sum of the basic exclusion amounts that were allowed the decedent in computing the gift tax, if higher than the basic exclusion amount in effect at the decedent's death.

The effect of the clawback can be seen in the following example. Assume Pat (an unmarried person) makes a gift of \$12,000,000 in 2025, and then dies in 2026 with a remaining estate of \$3,000,000. For purposes of this example, assume \$5.0 million with Cost-of-Living Adjustment ("COLA") in 2026 (year of death) is \$6.2; and \$10.0 million with COLA in 2025 (year of gift) is \$12.0.

Estate Tax Return, Form 706 – Estate Tax Calculations:

	Column A	Column B	Column C	Column D
	No Gifts	W/Clawback	W/O Clawback	Partial Use
Taxable Estate	\$15,000,000	\$3,000,000	\$3,000,000	\$9,000,000
Adjusted Taxable Gifts	\$0	\$12,000,000	\$12,000,000	\$6,000,000
Total	\$15,000,000	\$15,000,000	\$15,000,000	\$15,000,000
Tentative tax	\$5,945,800	\$5,945,800	\$5,945,800	\$5,945,800
Total gift tax paid	\$0	\$0	\$0	\$0
Gross Estate Tax	\$5,945,800	\$5,945,800	\$5,945,800	\$5,945,800
Basic Exclusion Amount	\$6,200,000	\$6,200,000	\$12,000,000	\$6,200,000
Applicable Credit Amount	\$2,425,800	\$2,425,800	\$4,745,800	\$2,425,800
Net Estate tax	\$3,520,000	\$3,520,000	\$1,200,000	\$3,520,000

Column A shows Pat's Estate Tax Calculation if no taxable gifts are made, with the Net Estate Tax of \$3,520,000.

Column B shows Pat's Estate Tax Calculation if clawback were to be allowed -- the estate tax is computed on the full estate of \$15.0 million, offset with the basic exclusion amount of \$6.2 million, resulting in a Net Estate Tax of \$3,520,000. This is the same Net Estate Tax as if Pat made no taxable gifts.

Column C shows Pat's Estate Tax Calculation under the Proposed Regulations, where the basic exclusion amount in the year of death is equal to the sum of the basic exclusion amounts allowed Pat in computing the gift tax on post-1976 gifts, or \$12.0 million, resulting in a Net Estate Tax of \$1,200,000.

Use it or Lose it

The increased basic exclusion amount under TCJA favors those with very large estates over those with just large estates. That is, a client with a \$50 million estate may be comfortable making taxable gifts of \$12 million; however, a client with just a \$15 million estate is not typically comfortable making taxable gifts of \$12 million. Many people may be able to make a roughly \$6 million taxable gift, but can not make a \$12 million taxable gift. Unfortunately, to get the full benefit of the increased exclusion amount, a person must gift the full increased exclusion amount before it sunsets.

For example, if Pat has \$15,000,000, Pat would most likely not be willing to give away \$12,000,000. So Pat proposes to split the difference, giving away \$6,000,000 on December 1, 2025, leaving Pat's \$5,000,000 (plus COLA) exemption intact. Column D shows this strategy does not work, and results in the same Net Estate Tax as if Pat made no taxable gifts. That is, to get the benefit of the full increased exclusion

amount, Pat has to gift the full increased exclusion amount – Pat must use it or lose it. Unless, of course, Congress makes permanent the increased exemption. (See EGTRA.)