

Preventing Estate and Gift Exemption Clawback Seen as 'Vexing'

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Congress may have given the IRS explicit instructions to issue regulations to prevent a clawback of the estate and gift tax exemption, but actually writing those regs may be more than just a mere formality.

The Tax Cuts and Jobs Act ([P.L. 115-97](#)) added a new paragraph to [section 2001\(g\)](#), which directs Treasury to promulgate regulations regarding any difference between the exclusion amount at the time of a gift and at the time of death.

Though the TCJA doubled the exclusion amount — from \$5 million to \$10 million, before adding the inflation adjustment — that provision is set to expire beginning in 2026, absent further action by Congress. That leaves estate planners questioning whether transfers completed during the interim period of higher exclusion levels might be clawed back if the law reverts to its pre-TCJA form.

“Clawback is vexing,” Ronald D. Aucutt, chair emeritus of McGuire Woods LLP’s Private Wealth Services Group, told Tax Analysts. In 2010, lawmakers addressed clawback concerns over shifting estate and gift tax rates in [section 2001\(g\)\(1\)](#), but inexplicably did not do so for exemption amounts, he said.

In the TCJA, lawmakers seemingly could have inserted a mirror paragraph applying the same concept to exemptions, Aucutt said, but “Congress stopped short of doing that, either finding it too complicated or running out of time or just not thinking about it at all, and left it to Treasury to handle.”

Aucutt pointed out that since 1976, dealing with the exemption amount has been more complicated than rates. Unlike rates, the exemption calculation is affected by the adjustment for gifts made during a brief period in late 1976 as specified in [section 2010\(b\)](#). He also explained that during periods when exemptions have increased, it’s possible to make gifts that use up the entire estate tax credit available at the time, but in subsequent years find that exemption increases would have completely covered the gift if the client had waited.

Congressional Punt

“This creates a need for reconstructions of might-have-been scenarios that can become tedious, complex, and even counterintuitive,” Aucutt said. He suggested that that kind of complexity may be part of why Congress punted on writing the rule into the statute itself.

Although it’s still unclear why Congress decided to hand the problem over to Treasury, James F. Hogan, a former attorney in the IRS Office of Chief Counsel and chief of the Estate and Gift Branch, said one benefit of that approach is that Treasury and IRS staff will have more time to dive into the weeds on a clawback rule, as well as give practitioners the opportunity to weigh in on any proposed rule before it becomes final.

However, Hogan, now with Andersen Tax LLP, observed that there's little guidance in the TCJA's conference committee report as to what lawmakers intended when they added [section 2001\(g\)\(2\)](#).

The wording in section 2001(g)(2) seems to permit Treasury to only provide a new formula to make the clawback go away, much like paragraph (1) does for rates, according to Aucutt, thus providing narrow regulation-writing authority to Treasury.

That narrowness helps offset some of the murkiness around lawmakers' intent, James G. Blase of Blase and Associates LLC told Tax Analysts. If the regulations the IRS eventually releases aren't favorable to the taxpayer, it may result in a strong basis for a legal challenge.

"The IRS can only act within the congressional grant of authority. The IRS was not granted the unlimited power to issue any regulations they wish to release," Blase said.

There remains a slight possibility that Treasury's regulations could disappoint, according to Aucutt, such as by overlooking some "intricacies of the reconstructions" or by overthinking the issue and creating regs that only make compliance more burdensome and complex.

Aucutt also said to watch how a different kind of clawback — what is referred to as "off the top" or "off the bottom" — is treated. He said some practitioners are curious whether a current gift of less than the new, full-exemption amount is considered to be using up their "bonus" exemption amount, or the pre-TCJA amount. It's unclear, Aucutt said, if a person who makes a \$5 million gift today would still have the \$5 million base exemption plus inflation remaining if they die after 2026.

Aucutt said it is unlikely that Treasury's regs will address that issue, and that if that's the case, some estate planners might be disappointed not to have that clarity.

Much Ado About Nothing?

Some practitioners, however, responded to the exemption uncertainty with little more than a shrug.

Larry Katzenstein of Thompson Coburn LLP was unconcerned about the prospects of a clawback fix. Although it might be complicated to come up with a fix, Congress has "made it clear that there won't be clawback, so I'm not worried," he said.

Katzenstein said that with the estate and gift tax provision set to expire in eight years, it could be a while before Treasury issues guidance. But he also said that if the new exemption levels become permanent — which he predicted was "very possible" — then the clawback concern would no longer be a problem anyway.

Others indicated they expect a swifter resolution. With the estate and gift tax clawback issue now featured on the [updated 2017-2018 priority guidance plan](#), Aucutt said he expects action "fairly soon . . . and I really do expect that the estate planning community will be satisfied with the answer."

Likewise, Hogan said that he was "encouraged" to see the estate tax exemption issue listed on the guidance plan, although he said he could see the clawback guidance falling behind because of the breadth of guidance projects

that Treasury must deal with.

Aucutt suggested there may be a point in favor of regulatory urgency that is rooted in the past. Fearing a repeat of 2010 and 2011, when the estate tax was temporarily repealed and the estate planning community was thrown into confusion, IRS and Treasury officials may not want to wait for 2026 to get any closer than necessary.

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