



ALERT - Planning Issues when Using the Temporarily High Gift/Estate Tax Exemption

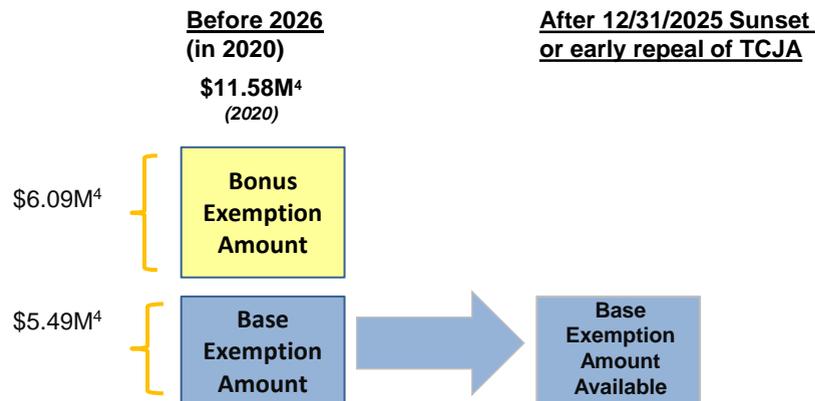
Overview

The Tax Cuts and Jobs Act “TCJA” of 2017 roughly doubled the Applicable Exemption Amount¹ until 2026. Clients often incorrectly believe that pre-2026, gifts above the annual gift exclusion use up the temporary “Bonus” Applicable Amount first². In fact, pre 2026 gifts result in a “bottom-up” calculation that uses up the Base Exemption amount first. This Handout illustrates the application of Treas. Reg §20.2010-1(c). Absent action by the Congress and the President, the higher exception amount will revert back to the 2017 amounts adjusted for inflation (about half) in 2026.

Background

- Before 2018, the Applicable Exemption Amount was \$5.49 million per person³.
- In 2019, the Applicable Exemption amount indexed up to \$11.18 million per person under the TCJA. In 2020, the Applicable Exemption Amount indexed up to \$11.58 million per person.

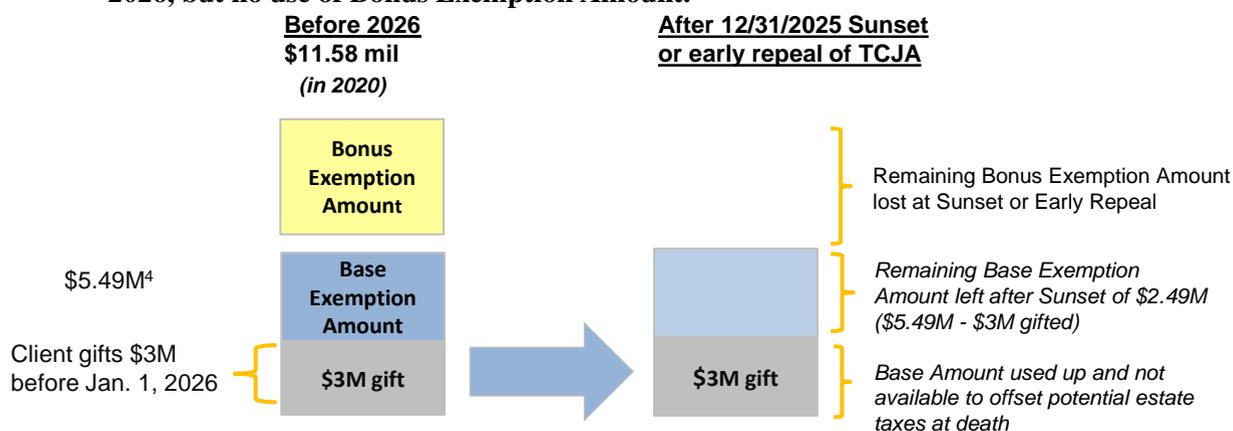
How the Exemption Amount Could Decrease



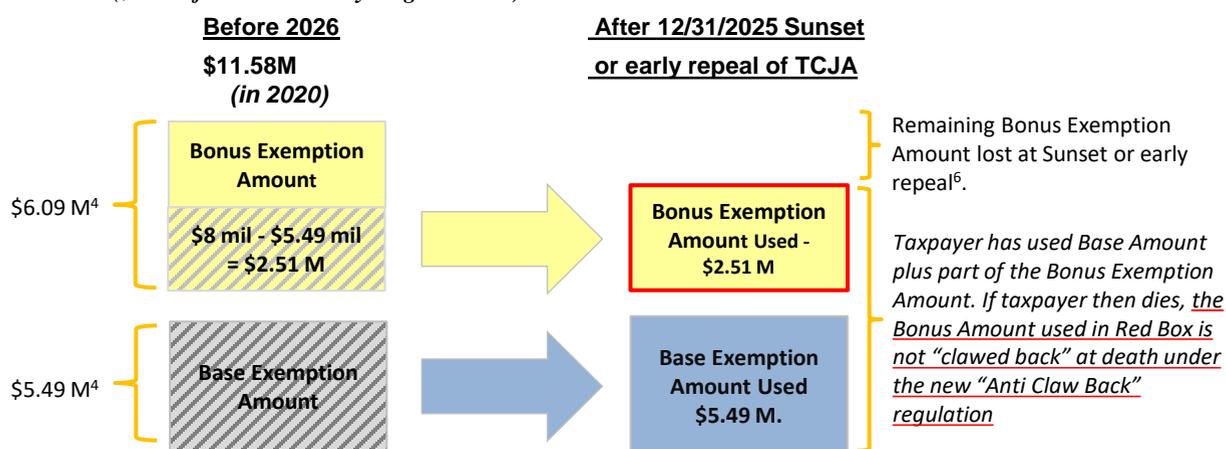
Common Misunderstandings of the Bonus Amount when Gifting

To take advantage of the Bonus Exemption Amount, clients ask about gifting the “Bonus Exemption Amount” now before Sunset or early repeal. However, to use the Bonus Exemption Amount, a client needs to gift more than the Base Exemption Amount. In Example 1 under the Regulations, the IRS clarified that gifts during the period of 2018-2025 do not use the Bonus Exemption Amount “first.” Rather the calculation is a “bottom-up” calculation that uses up the Base Exemption Amount first.

Example 1 Illustrates the effect of Gifting \$3 Million Above the Annual Gift Exclusion⁵ before 2026, but no use of Bonus Exemption Amount.



Example 2 Illustrates a \$8M Gift above the Annual Gift Exclusion⁵ before Jan. 1, 2026.
(*\$8M Gift is illustrated by diagonal lines*)



Client has used all of the Base Exemption Amount plus \$2.51M of the Bonus Exemption Amount and has \$3.58M (\$6.09M - \$2.51M) of Bonus Exemption plus inflation adjustments remaining until Sunset or Early Repeal.

Summary

Treas. Reg. §20.2010-1(c) (November 2019) is often referred to as the “Anti-Claw Back Regulation” suggesting that it is taxpayer friendly. While it does prevent claw back in some circumstances (see the Red Border box in Example 2 above), for most taxpayers, it will have the effect of denying the taxpayer use of the “Bonus Exemption Amount” unless they make gifts that are larger than the Base Exemption Amount. The Treas. Reg does not address whether use of the generation skipping transfer tax exemption above the Base Exemption Amount will be clawed back, the generation skipping transfer tax exemption was also doubled by the TCJA. The IRS said that there is nothing in the statute that would indicate that sunset would have any impact on allocations of GST exemption between 2018 and 2025, but providing regulatory guidance was “beyond the scope of this rulemaking.” The Treas. Reg does address that there will be no clawback of a properly claimed Deceased Spouse’s Unused Exemption Amount (DSUEA) that is available to the surviving spouse through portability.

Follow Up

Planning techniques are available. If you have questions, please call our office to speak to one of our attorneys.

Endnotes

- Note 1. This is sometimes referred to as the “unified credit amount.”
- Note 2. For ease of discussion we will refer to the temporary increase as the “Bonus Exemption Amount”
- Note 3. This amount is \$5M but subject to inflation adjustments it is now \$5.49M in 2020.
- Note 4. For illustration purposes we have used the 2020 amounts.
- Note 5. In 2020, the Annual Gift Exclusion amount is \$15,000 per donee or \$30,000 per donee for married couples who “gift split”.
- Note 6. If the taxpayer dies before Sunset or Repeal and the Estate files an Estate tax return to preserve the DSUEA it is not lost.

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