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IRS Proposed Regulations - No IRS 'Clawback' of the Temporarily Increased Basic Exclusion Amount

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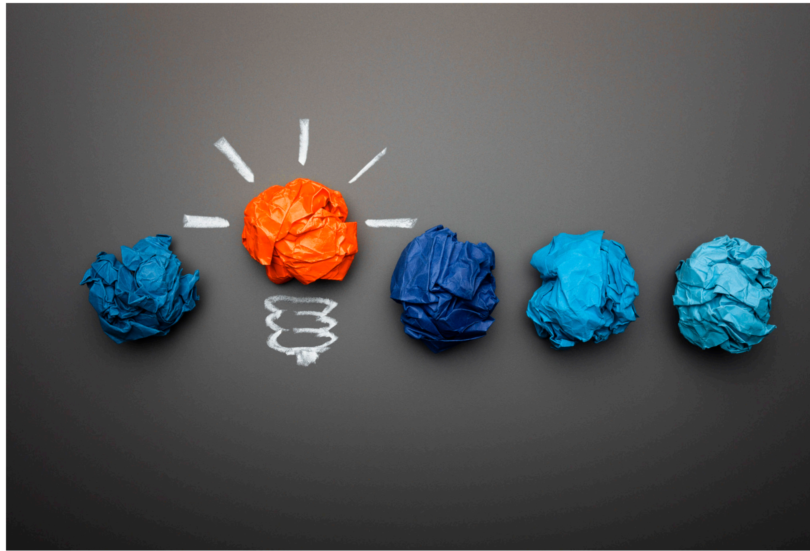
On November 21, 2018, the Internal Revenue Service ("IRS") issued a proposed regulation (REG-106706-18) (the "Proposed Regulations") to address some concerns raised by tax reform as part of Public Law 115-97, formerly known as the Tax Cuts and Jobs Act (the "Tax Reform Bill"). Please note that the description below includes a simplified description of tax laws and that a tax professional should be consulted for any tax planning or tax filing purposes.

Prior to the Tax Reform Bill, an individual's taxable estate and taxable gifts were subject to a basic exclusion amount (the "BEA") of approximately $5 million, meaning that only assets in excess of $5 million were subject to gift and estate tax. As part of the Tax Reform Bill, the BEA was effectively doubled to approximately $10 million by an amendment to Internal Revenue Code §2010(c). However, this provision sunsets in 2025 and reverts back to the previously enacted $5 million (as adjusted for inflation).

The sunset of the increased BEA has been heavily debated until the recent Proposed Regulations. The Proposed Regulations prevent the possibility of what is colloquially referred to as a "clawback." For example, Mr. Smart, an unmarried individual, makes a taxable gift in 2019 of $9 million with no prior gifts. Under the Proposed Regulations, his 2019 taxable gift would not be subject to any tax liability regardless of the date of death since at the time of the gift it was below the enacted BEA.

Prior to the Proposed Regulations, the sunset of the $10 million BEA would create potential for a clawback. Again, take Mr. Smart, an unmarried individual who has made no taxable gifts prior to 2018. Mr. Smart makes a taxable gift in 2019 of $9 million. At the time of his taxable gift, it was not subject to gift tax. However, a clawback would occur if Mr. Smart passed away in 2026 and his estate would have a tax liability associated with his 2019 taxable gift as it was greater than the BEA at the time of death. The clawback of his 2019 taxable gift reduces the benefit of the increased BEA due to the sunset provision.

The Proposed Regulations reduces uncertainty surrounding taxable gifts made prior to 2026. In addition, it creates a "use-it or lose-it" scenario, as individuals are incentivized to make gifts up to the temporarily increased BEA of approximately $10 million (subject to additional inflation adjustment). The Proposed Regulations are open for a comment period through March 2019. Upon finalization, the Proposed Regulations will provide surety as well as a call to action for estate tax planning.



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