

WITH AMBIGUITY RESOLVED IT MAY BE TIME TO TAKE ACTION

By Carolyn Ohlsen, Managing Partner
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The Internal Revenue Service (“IRS”) has taken measures to clear up uncertainty under the Tax Cuts and Jobs Act (“TCJA”), which was enacted on December 22, 2017. The TCJA was the legislation that increased the federal estate and gift tax exemption to \$11.18 million per person, effective for the period of 2018 through the end of 2025. This increase approximately doubled the estate, gift and generation-skipping transfer tax exemptions. The exemption amount has further increased with inflation to \$11.40 million in 2019 and \$11.58 million in 2020. Moreover, the TCJA provides that, starting in 2026, the gift and estate tax exemption will revert to \$5 million, per person, plus inflation adjustments. The TCJA, as illustrated below, modified the estate, gift and generation-skipping transfer tax exemptions.

This temporary increase in the federal estate and gift tax exemptions raised several questions. What would happen if gifts were made before 2026 in amounts that exceeded the \$5 million federal estate and gift tax exemption? What would happen if the donor passed away or made additional taxable gifts after 2025? Would “excess” gifts made before 2026 be subject to estate tax if the donor died after 2025 and the tax exemption had decreased?

Practically speaking, if a donor makes a \$10 million dollar gift in 2020 and dies in 2027, can the IRS retroactively apply the \$5 million dollar amount? The possibility of that “catch” was a great concern – whether the gifts would be taxed later when the exemption fell.

The TCJA authorized the IRS to impose regulations to answer the question. The Treasury Department and the IRS have now issued final regulations to resolve the concern.

The Regulations

The final regulations became effective on November 26, 2019. These regulations will affect taxpayers who make gifts after 2017 and the estates of decedents dying before 2025. The regulations provide that the taxpayer will not be caught in a retroactive application of the lower exemption. In other words, if a donor uses their full pre-2026 exemption, the exemption will continue to protect gifts even if the donor survives long after 2026.

Treasury Regulation Section 20.2010-1(c) ensures that, if a decedent uses the increased basic exclusion amount

for gifts made while TCJA is in effect and dies after the exemption reverts to \$5 million (although still as increased for inflation), the amount prior to the TCJA, such decedent will not be treated as having made adjusted taxable gifts solely because the increase in the basic exclusion amount effectuated by the 2017 Tax Act was eliminated. Therefore, when a taxpayer makes a gift under the current exemptions, that taxpayer will not be adversely affected by the exemption decreasing at the end of 2025 and the benefit of the higher exemption will not be retroactively eliminated.

The regulation answers that question and answers it favorably. But it also addresses and limits what the IRS would consider opportunities to take advantage of the rules to try to go further than Congress intended.

A provision in the regulations provides that taxpayers who intend to take advantage of the increased exemptions

Portability

Treasury Regulation Section 20.2010-1(c) also addresses the TCJA's affect on the concept known as "portability" which allows a surviving spouse to carryover any exemption remaining and unused by the deceased spouse, effectively doubling the estate tax exemption available to a married couple. The final regulations confirm that the increased exemption amount for a decedent dying between January 1, 2018, and December 31, 2025, will be frozen and any unused exemption based on the doubled amount will remain available to a surviving spouse. While many assumed that this was the case, it is reassuring to see it finalized in a Treasury Regulation.

Recommendation

In light of the above, you may wish to review your estate plan to ensure that the effects of the new regulations remain consistent with your tax and family planning goals. Lowenhaupt & Chasnoff can help determine the best utilization for your situation. To establish a plan moving forward please contact our team of attorneys for a detailed evaluation of your current estate plan.

before 2026 should do so in a timely fashion. That is because an ordering rule directs that a taxpayer who uses exemption is deemed to use the base \$5 million exemption first and then the additional layer of exemption is available through 2025. Taxpayers cannot claim that they used the increased portion of the exemption first so that the base remains after 2025.

The original uncertainty about what would happen to the exemption amount in 2026 had been a deterrent to those anxious to utilize their new doubled exemption now \$11.58 million to make gifts of more than \$5 million. These final regulations should open the door to substantial gifts free of concerns that the gift might be caught in a technical reversal. In fact, with the enactment of this regulation, the sooner a donor makes a large gift, the better. While the estate and gift tax exemption is always subject to change, the possibility of a new political party in the White House, House of Representatives and Senate in 2020 gives an additional incentive to make a large taxable gift. The time to act is now.

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Carolyn Ohlsen is Managing Partner of Lowenhaupt & Chasnoff, a law firm has been providing counsel to families of substantial wealth. Carolyn leads a team of attorneys advising individuals and families on all phases of estate, trust and business entity planning including tax, administration and legacy development. Carolyn represents taxpayers in private letter rulings and transfer tax audits, and received the designation of Accredited Estate Planner (AEP) from the National Association of Estate Planners and Councils, in 2007 and the Global Fiduciary Strategist (GFS) designation and a Certificate in Fiduciary Governance from the Thunderbird Walker Center for Global Entrepreneurship, in 2012. Carolyn has lectured and chaired numerous professional level courses and other programs on sophisticated estate planning topics, structuring for retirement assets, and transfer taxes. Carolyn earned an MBA from Saint Louis University and a law degree, cum laude, from Saint Louis University. She also earned a Bachelor of Science degree, magna cum laude, from Saint Louis University.