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IRS Clarifies Uncertainty Surrounding Lifetime Gifting and Increased Basic Exclusion Amount Under TCJA

ESTATE PLANNING, TAX, TAX REFORM, TCJA
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Over the past year, Schneider Downs has been busy tracking the drafting, passage and, as of late, the Internal Revenue Service's implementation of the Tax Cuts and Jobs Act ("TCJA"). From an Estate and Trust perspective, few changes under the TCJA have generated as much buzz as the doubling of the estate and gift tax basic exclusion amount. Thanks to the TCJA, taxpayers are now able to gift their designated beneficiaries up to $10 million, which when adjusted for inflation equals $11.18 million in 2018. But despite the ability to now shelter twice as much money from the estate and gift tax as taxpayers could under prior law, estate planners have been cautious to recommend taking advantage of these increased limits due to a key expiration provision included in the post-TCJA code.

Under the estate and gift tax regime, there are, practically speaking, two ways a person can take advantage of the basic exclusion amount. A taxpayer can either (1) die and take the full amount of the exclusion against their taxable estate, or (2) make various gifts throughout their lifetime, and to the extent that any gift exceeds the annual gift tax exclusion amount, the taxpayer then utilizes their basic exclusion amount during life.

The problem for tax planners, until recently, has been that the increased exclusion expires on December 31, 2025. The issue then, is that if the taxpayer utilizes the increased exclusion during his or her lifetime, but then dies after December 31, 2025 (when the basic exclusion reverts back to $5 million as adjusted for inflation), the taxpayer could be forced to pay estate tax on the additional amounts gifted. The practical effect of the expiration provision meant that, in order to take advantage of the exclusion a person had to die after December 31, 2017 but before January 1, 2026.

On November 23, however, the IRS released proposed regulations which, if made permanent, would permit a taxpayer to gift the entire increased basic exclusion amount without being penalized if the taxpayer passes away after the basic exclusion has reverted back to $5 million as adjusted for inflation. In basic terms, what the IRS has said is that if a taxpayer passes away after the basic exemption has reverted back to pre-TCJA levels, and the taxpayer owes estate tax because of gifts made in reliance on the increased basic exclusion amount, a credit will be applied to offset the tax liability incurred by the additional gifts. The result: estate planners can now advise clients to gift up to the increased basic exclusion amount without the uncertainty of the taxpayer surviving the expiration of the TCJA provision.

It is important to remember that proposed regulations can change before being finalized and should not be relied upon. However, these new regulations come as welcome insight into the IRS thought process and how it intends to provide certainty to long-range estate plans in a tax environment with few long-term laws.

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