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LUKINOVICH
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Suggested Reading:

The New One Minute Manager
By Ken Blanchard/Spencer Johnson MD

This book is a must read for all leaders and managers operating in a constantly changing world

GIFTING UNDER THE TRUMP ERA TAX LAWS

Kathryn P. Garitty

It has been long established under the Internal Revenue Code that an individual may pass a portion of his or her estate free of federal estate and gift tax. This portion that may pass free of federal estate and gift tax is known as the Applicable Exclusion Amount, and the Applicable Exclusion Amount has changed over the years depending on which political party is in power. In 2017 Congress passed, and the President signed into law, the Tax Cuts and Jobs Act ("TCJA") which reduced the number of estates impacted by the federal estate and gift tax because this new law temporarily **doubles** the Applicable Exclusion Amount. Under the TCJA, beginning in 2018, the **Applicable Exclusion Amount increased** from $5,000,000.00 per person (indexed for inflation) **to $10,000,000.00 per person** (indexed for inflation). However, under the TCJA, beginning January 1, 2026 the increased Applicable Exclusion Amount will revert back to $5,000,000.00 per person (indexed for inflation). Although the increased Applicable Exclusion Amount can be a boon to large estates if properly utilized before January 1, 2026, it also creates uncertainty as to its impact to estates when it decreases by half on January 1, 2026.

First, with regard to the benefits to be derived from the increased Applicable Exclusion Amount, in November 2018, the IRS proposed regulations (Reg. 106-706-18) that clarify that **gifts made prior to January 1, 2026 that utilize the increased Applicable Exclusion Amount will remain estate and gift tax free** and will not lose the tax benefit of the higher Applicable Exclusion Amount after it decreases. In other words, such gifts will not be subject to a "claw back tax" after the Applicable Exclusion Amount decreases but, instead, will remain estate and gift tax free and will not be subject to gift or estate tax at any time in the future. It is important to note, however, that the increased Applicable Exclusion Amount is a "use it or lose it" benefit. To preserve the increased Applicable Exclusion Amount past December 31, 2025, an individual must first use up his or

her original Applicable Exclusion Amount of $5,000,000.00 (indexed for inflation) ***prior to*** January 1, 2026 and thereafter, ***within the same time period***, make additional gifts of up to $5,000,000.00 (indexed for inflation). If the original Applicable Exclusion Amount of $5,000,000.00 is utilized but no additional gifts are made prior to January 1, 2026, the ability to utilize the increased Applicable Exclusion Amount is lost, unless Congress votes to extend the time period for the increased Applicable Exclusion Amount beyond December 31, 2025.

Despite the gift tax benefit of a "no claw back tax" if the increased Applicable Exclusion Amount is utilized prior to January 1, 2026, **uncertainty arises as to the estate tax benefits** for the estate of the spouse who is the second to die, **if the first spouse dies prior to January 1, 2026 without having made gifts that fully utilize the increased Applicable Exclusion Amount and the second spouse dies on or after January 1, 2026 when the increased Applicable Exclusion Amount is reduced by one-half.** To understand the dilemma presented, it is helpful to have some background information as follows.

In December 2010, and again in 2013, Congress passed legislation to allow portability of the Applicable Exclusion Amount between married couples. The porting of the Applicable Exclusion Amount from a deceased spouse to a surviving spouse is triggered when the first spouse dies and the value of the estate does not require the use of all of that deceased spouse's Applicable Exclusion Amount to create a zero estate tax liability. In such a case, the amount of the Applicable Exclusion Amount that was not used for the deceased spouse's estate, commonly known as the Deceased Spouse's Unused Exemption ("DSUE"), may be ported over or transferred to the surviving spouse so that the surviving spouse can use the deceased spouse's unused Applicable Exclusion Amount ("DSUE"), ***plus*** his or her own Applicable Exclusion Amount, when the surviving spouse later dies.

So, for example, assume that Joe and Barbara have a combined estate valued at $10,000,000.00. Joe dies on June 15, 2017, when the Applicable Exclusion Amount is $5,000,000.00 (adjusted for inflation), without having made any lifetime gifts. Further assume that Joe's estate is valued at $5,000,000.00 and that he leaves $3,000,000.00 of assets to his children and $2,000,000.00 of assets to Barbara. Under this scenario, Joe has used only $3,000,000.00 of his Applicable Exclusion Amount of $5,000,000.00. The $2,000,000.00 to Barbara passes pursuant to the unlimited marital deduction and does not utilize any of Joe's Applicable Exclusion Amount. Thus, assuming that the Executor of Joe's estate timely files a Form 706 (United States Estate (and Generation Skipping Transfer) Tax Return), in order to make an affirmative DSUE election to port Joe's unused Applicable Exclusion Amount over to Barbara, Barbara will have a total Applicable Exclusion Amount at her death of $7,000,000.00 ($5,000,000.00 Applicable Exclusion Amount of her own plus $2,000,000.00 DSUE from Joe).[1]

[1] Under current law, the ability to make an affirmative DSUE election to port a deceased spouse's unused Applicable Exclusion Amount over to the surviving spouse does ***not*** also allow the portability of a deceased spouse's unused Generation-Skipping Transfer ("GST") Tax Exemption to the surviving spouse.

Assume that Barbara dies on November 30, 2017 with an estate valued at $7,000,000.00. Since Barbara has a total Applicable Exclusion Amount of $7,000,000.00 available to her estate, her estate will pay zero federal estate taxes ($7,000,000.00 estate - $7,000,000.00 total Applicable Exclusion Amount). The portability of Joe's Applicable Exclusion Amount will save this couple about $800,000.00 in federal estate taxes ($2,000,000.00 amount ported from Joe's estate through an affirmative DSUE election × 40% estate tax rate = $800,000.00 estate/gift tax savings).

With the foregoing framework in mind, an issue of potential uncertainty arises as to what amount of the DSUE is available to a surviving spouse if the first spouse dies between January 1, 2018 and December 31, 2025 (the period during which the increased Applicable Exclusion Amount is $10,000,000.00 adjusted for inflation) ***without having made lifetime gifts*** and the surviving spouse dies after December 31, 2025 (when the Applicable Exclusion Amount reverts back to $5,000,000.00 adjusted for inflation).

Specifically, suppose for this example that Joe dies in 2019 without having made any lifetime gifts and is survived by his wife, Barbara. The executor of Joe's estate timely files an estate tax return and elects to port all $10,000,000.00 of Joe's DSUE to Barbara. Barbara dies in 2026, after the Applicable Exclusion Amount has reverted back to $5,000,000.00. What amount of Joe's DSUE is available to Barbara's estate? Is it $5,000,000.00 or $10,000,000.00?

The IRS has not expressed a position on this issue at this time. However, it is believed by some commentators that the DSUE available at the second spouse's death will be limited or restricted to $5,000,000.00 so that, in our example, the total exemption available to Barbara at her death would be $10,0000.00 ($5,000,000.00 limitation on the DSUE she received from Joe plus her then current $5,000,000.00 Applicable Exclusion Amount). Under this interpretation of the law, Barbara loses $5,000,000.00 of Joe's potential $10,000,000.00 DSUE. The impact of this loss would be $2,000,000.00 of estate/gift tax savings ($5,000,000.00 × 40% estate tax rate) ***plus*** any growth or net income that could have been generated on the future investment of that $2,000,000.00 in estate/gift tax savings.

Under these facts, if the IRS determines that the DSUE of the first spouse to die is limited to the $5,000,000.00 in effect when the second spouse dies, then a strategy for ensuring that the full amount of the increased Applicable Exclusion Amount is utilized is for each spouse to make lifetime gifts of at least one-half of the increased Applicable Exclusion Amount before January 1, 2026, as well as lifetime gifts of each year's cost of living adjustment as to half of the presently increased Applicable Exclusion Amount. This strategy would limit the amount of portability potential for the estate of the first spouse to die to the $5,000,000.00 of Applicable Exclusion Amount that will survive beyond December 31, 2025 and would allow full use of the increased Applicable Exclusion Amount. Additionally, if one spouse dies during the period of his or her increased Applicable Exclusion Amount and the DSUE is ported to the surviving spouse, the surviving spouse should consider making additional gifts reducing the surviving spouse's available DSUE to half of the amount of the increased Applicable Exclusion Amount or less.

There are a few takeaways from this discussion that should be remembered. First, between January 1, 2018 and December 31, 2025, the Applicable Exclusion Amount has doubled from $5,000,000.00 (adjusted for inflation) to $10,000,000.00 (adjusted for inflation). Second, gifts made prior to January 1, 2026 that utilize the increased Applicable Exclusion amount will not be subject to a "claw back tax" after the Applicable Exclusion Amount reverts back to $5,000,000.00. Third, the increased Applicable Exclusion Amount presents planning opportunities for gifting during life but can create uncertainty at death depending upon a client's own unique circumstances. Of course, each client's circumstances are unique and there is no "one size fits all" estate plan. The sole purpose of this letter is to inform our clients and contacts of potential planning opportunities under the current tax law. Please call our office if you have questions or would like to explore how these issues may impact your particular situation.

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