# THE GOVERNMENT GIVETH—AND THE IRS TAKETH AWAY

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In 2018, the basic exclusion amount ("BEA" or commonly called the "exemption") for estate taxes doubled from $5 to $10 million. Today, it sits at $12.92 million. But absent an act of Congress, this exemption will revert to an inflation-adjusted $5M in 2026—which is estimated to be $7.2 million. Not surprisingly, Advisors have been recommending that their high-net-worth clients attempt to use this exemption before they lose it. And while this can be wise, as a couple could potentially lose $13 million in tax-free wealth transfer, you should be aware that some strategies may be subjected to a clawback.

## What's a "Clawback"?

Put simply, a clawback is when the IRS takes back a tax benefit your clients have previously enjoyed. And even though, in 2019, the Treasury ruled that a decedent could use the greater of the exemption at the time of death or the exemption applied toward his or her lifetime gifts—effectively alleviating this clawback concern, they recently issued proposed regulations that may change this. Before we go further, let's get a better idea of what we're talking about.

The question is whether a decedent in 2026 would benefit from the utilization of the increased exemption during 2018-2025 or not. The example below illustrates how the exemption works today and how a clawback could effect it. As you can see, if a decedent dies with a $5 million estate and made lifetime gifts of $10 million between 2018-2025, with the exemption today, the net taxable estate would be $2 million. However, if there was a clawback, there would be a $6M change in the exemption applied to the lifetime gifts and the net taxable estate would be $8 million. So, if the IRS says there's no clawback, why does this matter?

## New Proposed Regulations

The Treasury has proposed new regulations that effectively disallow the use of the excess exemption from years 2018-2025 for certain types of gifts. For these specific situations, the decedent would utilize the exemption available at the time of his or her death, rather than the exemption applied at the time of the gift. However, it is worth noting that an outright gift not included in the decedent's estate would not be subject to this clawback rule.

## What Gifts Are Impacted?

The most common types of gifts we expect to be affected by the new proposed regulation are those included in the decedent's estate or subject to special valuation rules (typically because the decedent maintained an ownership interest in the gift), like:

- **Grantor Retained Annuity Trusts** (GRATS) are subject to the clawback if the gift represents more than 5% of the GRAT funding. So, zeroed-out GRATs would not be subject to this clawback rule.

| ESATE TAX CALCULATION: | DEATH PRIOR TO 2026 ($13M Exemption) | DEATH IN OR AFTER 2026 ($7M Exemption) |
|---|---|---|
| Gross Estate | $5M | $5M |
| **PLUS**: Lifetime Gifts | $10M | $10M |
| Adjusted Estate | $15M | $15M |
| **LESS**: Exemption | $13M | $7M |
| **NET TAXABLE ESTATE** | **$2M** | **$8M** |

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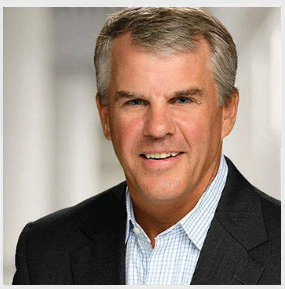
- **Qualified Personal Residence Trusts** (QPRTS) are frequently subject to the clawback, as the gift is typically more than 5% of the QPRT funding.
- **Family Limited Partnerships** (FLPs) are subject to a clawback if the decedent has too much control over the FLP.
- **Preferred Freezes** are subject to special valuation rules, so the clawback could apply.
- **18 month and 3-Year Look-Backs** could subject decedents to the clawback if they give up a power that would include a gift in their estate within 3 years of death. An 18 month look-back can apply to other types of transfers.

## What's the Takeaway?

If you're hoping to use the increased exemption prior to 2026, exercise caution when recommending one of the gifting strategies identified above. It is also worth noting that some other wealth transfer strategies can be impacted by this new clawback rule, so it is always important to carefully review any strategies. The risk of running afoul of this rule is that the property may not simply be included in the decedent's estate, but also that the excess exemption used to shelter the gift prior to 2026 may not be available. Therefore, the entire value of the property may become taxable in the decedent's estate.

If you have any questions or comments about this potential clawback,
**PLEASE SPEAK TO YOUR CORIENT WEALTH ADVISOR.**



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As a licensed attorney, Certified Financial PlannerTM designee, former accountant, and compliance officer, John Schuman brings a unique perspective and an unmatched depth of experience to the Wealth Transfer Group. As Head of Wealth Transfer, John will leverage his expertise in estate planning and taxation, income tax, general business and succession planning, and charitable and retirement planning.