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IRS PROPOSES ANTI-ABUSE EXCEPTION TO ANTI-CLAWBACK REGULATIONS

In April 2022, the IRS issued a proposed regulation (REG-118913-21) that would provide an exception to the anti-clawback regulations that were adopted in November 2019. The proposed regulation would except from the anti-clawback rules “transfers includible in the gross estate, or treated as includible in the gross estate for purposes of section 2001(b).”

A. Background – The Anti-Clawback Rule.

Under the Tax Cuts and Jobs Act (“TCJA”), beginning on January 1, 2018, the basic exclusion amounts (“BEA”) for gift and estate tax purposes temporarily increased from \$5 million (indexed for inflation) to \$10 million (indexed for inflation). On January 1, 2026, the BEA will automatically decrease to \$5 million (indexed for inflation).

As a result of the TCJA, practitioners were concerned that a portion of a donor’s gifts made after January 1, 2018 and before to January 1, 2026 might be “clawed” back into such donor’s estate at death if he or she died after January 1, 2026, thereby denying the donor of the full benefit of the higher BEA amount on the previous gifts. In November of 2019, the IRS adopted “anti-clawback regulations” that allow a decedent’s estate to calculate its estate tax credit using the higher of the BEA applied to lifetime gifts or the BEA applicable at death. See Treas. Reg. §20.2010-1(c).

In the preamble to the anti-clawback regulations, the IRS foresaw certain potential abuses of these regulations. For certain inter-vivos transfers made during the increased BEA period that are included in the decedent’s estate after the BEA has decreased, the anti-clawback regulations actually produce a “bonus” because in calculating the estate tax for these types of transfers, the gift is excluded from “adjusted taxable gifts” on line 4 of the estate tax return. The IRS declined to address these potential abuses in the anti-clawback regulations, opting instead to reserve them for further consideration after proper notice and commenting.

B. The Proposed “Anti-Abuse” Exception.

In part to prevent the abuse foretold in the preamble of the anti-clawback regulations, the proposed regulation would add a new subparagraph (3) to Treas. Reg. §20.2010-1(c), excepting “transfers includible in the gross estate, or treated as includible in the gross estate for purposes of Code §2001(b)” from the anti-clawback regulations. However, the anti-clawback regulations will continue to

apply to transfers includible in the gross estate when the taxable amount of the gift is not material, i.e., when the taxable amount is 5 percent or less of the total amount of the transfer.

The proposed regulation specifically lists (without limitation) four specific categories of transfers that are excepted from the anti-clawback regulations. The four non-exhaustive categories of transfers that fall within the anti-abuse exception are as follows:

1. Transfers included in the gross estate under Code §§2035 – 2038 and §2042 regardless of whether all or any part of the transfer was deductible under Code §2522 (charitable deduction) or Code §2523 (marital deduction);

2. Transfers made by enforceable promise to the extent they remain unsatisfied as of the date of the decedent's of death;

3. Transfers described in Treas. Reg. §§25.2701-5(a)(4) or 2.2702-6(a)(1), i.e., certain applicable retained interests in corporations or partnerships (Code §2701) or trusts (Code §2702); and

4. Transfers that would have been described in Paragraphs 1 – 3 above “but for the transfer, relinquishment, or elimination of an interest, power or property, effectuated within 18 months of the date of the decedent's death by the decedent alone, by the decedent in conjunction with any other person or by any other person.... [unless] effectuated by the termination of the durational period described in the original instrument of transfer by either the mere passage of time or the death of any person.”

The proposed regulation would apply only to estates of decedents dying on or after April 27, 2022 but would apply even if the gift subject to the anti-abuse exception to the anti-clawback rules was made before April 27, 2022. This regulation is a proposed regulation and is subject to change. Proposed regulations are not binding. They carry no more weight in court than a position advanced in a brief.