“The Tax Cuts and Jobs Act ("TCJA") has complicated the once-straightforward decision of whether a married couple should elect to split gifts. Although TCJA temporarily doubles the lifetime gift and estate tax exclusion, the savings from using the enhanced exclusion may be reduced or even lost if a couple makes an unwise gift-splitting election. Indeed, the larger a married taxpayer’s gift in some cases, the less efficient may be his or her planning. The result is paradoxical given the drive to make significant gifts in order to use up the enhanced exclusion amount before it expires. Fortunately, strategies are available that can minimize the adverse consequences of gift splitting.”

Austin Bramwell and Katie Lynagh provide members with commentary that examines how the Tax Cuts and Jobs Act has complicated the once-straightforward decision of whether a married couple should elect to split gifts. The views expressed herein are the authors’ own.

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Here is their commentary:
EXECUTIVE SUMMARY:

The Tax Cuts and Jobs Act ("TCJA") has complicated the once-straightforward decision of whether a married couple should elect to split gifts. Although TCJA temporarily doubles the lifetime gift and estate tax exclusion, the savings from using the enhanced exclusion may be reduced or even lost if a couple makes an unwise gift-splitting election. Indeed, the larger a married taxpayer’s gift in some cases, the less efficient may be his or her planning. The result is paradoxical given the drive to make significant gifts in order to use up the enhanced exclusion amount before it expires. Fortunately, strategies are available that can minimize the adverse consequences of gift splitting.

FACTS:

Prior to TCJA, married individuals who made gifts during a calendar year were routinely advised to elect to split their gifts for that year with their spouses. The advantages of gift splitting were seemingly straightforward: by splitting gifts with a spouse, a married individual was (and still is) able to use the spouse’s lifetime gift tax exclusion as the donor’s own. For example, when the exclusion amount was $1 million per individual, one spouse could make a $2 million gift yet not have gift tax liability, so long as the spouses elected to split gifts (and neither spouse had previously made any taxable gifts). Gift splitting was also a convenient way to use both spouses’ exclusions without both spouses having to make gifts.

TCJA has now upended that previously straightforward advice. Under TCJA, the federal gift and estate tax exclusion amount has temporarily doubled from $5 million to $10 million, adjusted for inflation. After 2025, the exclusion will revert to $5 million per person, again adjusted for inflation. We call the $5 million exclusion that was available before TCJA and will continue to be available after 2025 the “original exclusion.” The additional $5 million available through 2025 we call the “enhanced exclusion.”

Under regulations recently proposed pursuant to the mandate of section 2001(g)(2) of the Code, an individual may lock in the enhanced exclusion amount by making gifts that use up the enhanced amount before 2026. To preserved the enhanced exclusion past 2025, an individual must first use up his or her original exclusion amount. The lock-in effect of using up the
enhanced exclusion does not begin under the proposed regulations until taxable gifts have first used up the original exclusion amount.

**COMMENT:**

The decision whether to split gifts or not is more complicated in the post-TCJA world than it was before. As discussed below, whether and to what extent a split gift will successfully use up the enhanced exclusion amount depends on the amount of the donor spouse’s gift.

*Gift equal to donor spouse’s exclusion.* Suppose that neither spouse has made prior taxable gifts, and that one spouse makes a taxable gift of $10 million in 2019. The $10 million gift is equal to the sum of both the donor spouse’s original exclusion amount and enhanced exclusion amount. (For simplicity in this example and those that follow, the effect of inflation adjustments is ignored.) Under the proposed regulations, therefore, the donor spouse will have successfully locked in the enhanced exclusion amount, provided that the spouses do not elect to split gifts for the year.

If instead the couple elects to split gifts, each spouse will be deemed to have made a gift of $5 million. The deemed gifts will use up each spouse’s original exclusion amount, but not any portion of either spouse’s enhanced exclusion amount. Unless the spouses make additional gifts or die prior to 2026, the couple will not benefit from the enhanced exclusion amount. For that reason, the spouses should almost certainly not split gifts for the year of the donor’s gift.

*Gift that exceeds donor spouse’s exclusion, but not by more than consenting spouse’s original exclusion amount.* Now suppose that the donor spouse makes a taxable gift of $12 million. The amount of the gift exceeds the donor’s own exclusion amount, including the temporarily enhanced exclusion amount under TCJA. Thus, it may seem that there is no downside to splitting gifts so that both spouses’ enhanced exclusions can be used.

If the spouses do elect to split gifts, however, then each spouse will be deemed to have made a gift of only $6 million. The spouses will lock in $1 million of enhanced exclusion each, or $2 million combined. That is a good outcome, but it is not optimal. If, instead, the spouses do not elect to split gifts, the donor spouse will be able lock in his entire $5 million enhanced exclusion amount. At a 40% rate, preserving all $5 million of the donor’s
spouse’s enhanced exclusion saves $2 million of tax, compared to only
$800,000 if the spouses split gifts and lock in only $2 million of their
combined enhanced exclusions.

Of course, there is an obvious downside if the spouses do not elect to split
gifts: The donor spouse will owe $800,000 of gift tax on the amount by
which his $12 million gift exceeds his $10 million exclusion amount. In
principle, paying gift tax is efficient, because the gift tax paid, if the donor
survives three years from the date of the gift, ultimately escapes estate
tax. Despite that advantage, however, most wealthy individuals prefer not
to pay gift taxes during lifetime.

If the donor spouse indeed prefers not to pay gift tax, a paradox arises. To
avoid gift tax, the couple will prefer to split gifts, but gift splitting, as
discussed, causes a waste of the couple’s temporarily enhanced exclusion
amounts. The couple’s wealth transfer planning will be more efficient if the
donor avoids gift tax liability simply by giving only $10 million and not
splitting gifts, rather than making a gift of the full $12 million target.

Estate tax planners often assume that giving more during lifetime is better.
“Give more now” is an especially compelling maxim in an era when the
enhanced exclusion is scheduled to expire. Yet the maxim is not always
correct: If a married individual wishes to make gifts that exceed his or her
exclusion amount, but does not want to pay gift tax, he or she may be
better off giving less.

**Strategies for making larger gifts without adverse consequences of gift
splitting.** To increase the amount of the couple’s gifts without either spouse
paying gift tax, the donor spouse could, as an alternative to a gift-splitting
election, make a gift to the other spouse. For example, suppose that the
donor spouse, as before, wishes to make taxable gifts of $12 million but
does not wish to pay gift tax. The donor spouse can make a $10 million
taxable gift and a $2 million gift to the other spouse that qualifies for the gift
tax marital deduction. The other spouse may then use the $2 million in
order to make taxable gifts of her own. Assuming no collapse of steps
under the step transaction doctrine, the goal of making $12 million of total
gifts is achieved, while the donor spouse’s enhanced exclusion amount is
fully used. As before, the spouses should not elect to split their gifts for the
year.
Another strategy is for the donor spouse to make the entire $12 million gift himself, but in stages over two different years, and split gifts only in one of those years. For example, the donor spouse could make a gift of $8 million in one year and not split gifts. The $8 million gift locks in $3 million of the donor’s enhanced exclusion. In the next year, the donor spouse can make a gift of $4 million and the spouses could then elect to split their gifts for that year. The donor spouse will then be deemed to have made another $2 million of gifts, thereby locking in his full enhanced exclusion amount, while still making gifts in the targeted amount of $12 million.

The staging strategy also makes it possible for there to be a single transferor rather than two. If the gift is made in trust, only one trust needs to be formed. Staging gifts and carefully managing the gift-splitting election, in short, can eliminate the possible adverse consequences of gift splitting. To manage the amounts of the gifts and the gift-splitting election, it is important that planners be aware of the gift-splitting election’s effect on use of the enhanced exclusion.

*Gifts that exceed the sum of the donor spouse’s exclusion and the consenting spouse’s original exclusion amount.* Now suppose that the donor spouse makes a gift of $16 million. With a gift of that size, gift splitting becomes virtually imperative. For one thing, without a gift-splitting election, the donor spouse will be liable for $2.4 million of gift tax on the difference between the $16 million gift and his $10 million exclusion amount. Moreover, if the couple fails to split gifts, only the donor spouse’s $5 million enhanced exclusion will be locked in.

In contrast, if the spouses elect to split gifts, each spouse will be deemed to have made a gift of $8 million. The deemed gifts would preserve $3 million of enhanced exclusion for each spouse, or $6 million total. In sum, the gift-splitting election preserves more of the couple’s enhanced exclusion than if the election is not made.

*Gifts that do not exceed the donor’s original exclusion amount.* What about relatively smaller gifts that do not exceed the donor spouse’s original exclusion amount? One spouse, for example, might make a gift of “only” $5 million. $5 million is a still lot of money to all but the wealthiest Americans, yet it would not use up any of the donor’s enhanced exclusion, even if the couple does not elect to split gifts. A gift-splitting election, therefore, might seem benign, given that it would not cause a waste of the enhanced exclusion.
Still, all else being equal, even with relatively small gifts, it seems that married couples should in general avoid splitting large taxable gifts. The reason is that the gift and estate tax system is cumulative. If the donor spouse makes a $5 million gift and the spouses do not split gifts, he is at least in a position to start using up his enhanced exclusion amount if he makes any additional gifts in later years. By contrast, if the spouses split gifts, the donor spouse will be deemed to have made a gift of only $2.5 million, and will have to make additional gifts in excess of $2.5 million in order to lock in his enhanced exclusion before 2026. Thus, it may be better for the couple not to split gifts.

**Further complications.** Of course, real world situations are not as simple as the examples discussed above. For example, one of the spouses may make annual exclusion gifts, and would normally prefer to split gifts in order to maximize use of the gift tax annual exclusion. Yet, as discussed above, there may be a downside if one spouse makes a large taxable gift in the same year. One solution may be for both spouses to make annual exclusion gifts so that splitting gifts becomes unnecessary.

**But I don’t want to make such large gifts!** Many wealthy individuals, even those whose net worth exceeds the TCJA-enhanced exclusion amount by many times, do not wish to part with as much wealth as is necessary in order to lock in the enhanced exclusion amount. For such taxpayers, a variety of strategies is available to permit the donor effectively to retain access to property transferred by gift. To take a popular example, one spouse could make a gift to a trust, sometimes called a “spousal lifetime access trust” or “SLAT,” for the benefit of both the other spouse and descendants.⁶

Other strategies involve making gifts that are designed to preserve the enhanced exclusion amount but that deliberately cause the property transferred by gift to be pulled back into the donor’s gross estate at death. For example, a donor might create a grantor retained income trust or “GRIT” funded with $10 million; if the remainder passes at the donor’s death to members of the donor’s family, the value of the entire gift to the GRIT will, under section 2702 of the Code, be $10 million, despite the donor’s retained right to income. Although the GRIT would be included in the donor’s gross estate under section 2036(a)(1) of the Code, the gift to the GRIT would, under the proposed regulations recently issued under section 2001(g)(2), successfully lock in the enhanced exclusion amount. The GRIT property would also qualify for a step up in basis under section...
1014 of the Code. Especially for taxpayers whose wealth does not exceed the sum of the original exclusion and the enhanced exclusion, an artificial gift such as a GRIT appears to be an ideal strategy.

Caution, however, dictates that planners advise against making artificial gifts in the near term. Commenters have informed Treasury and the IRS that they have the authority to shut down the use of artificial gifts in order to lock in the enhanced exclusion amount. Treasury may decide to do just that in final regulations. Thus, it is better to wait for final regulations before proceeding with an artificial gift that permits the donor to retain beneficial access to the property transferred.

Finally, married couples should not elect to split large artificial gifts. Thanks to a defect in section 2001(e) of the Code, the exclusion amount used up by the consenting spouse would not be restored even if the property is pulled back into the donor spouse’s gross estate at death. To avoid an artificial waste of the consenting spouse’s exclusion, therefore, the donor of an artificial gift should not split gifts with his or her spouse for the year of the artificial gift.

HOPE THIS HELPS YOU HELP OTHERS MAKE A POSITIVE DIFFERENCE!

Austin Bramwell
Katie Lynagh

CITE AS:
1 The gift-splitting election is available under section 2513 of the Internal Revenue Code of 1986 (the “Code” or “I.R.C.”).

2 In fact, gift splitting was never as simple as it appeared. To take one example, a married couple should not split gifts for a year in which one of the spouses made a gift to a qualified personal residence trust or “QPRT,” because if the donor spouse dies during the fixed term, the non-donor spouse’s exclusion will not be restored at his or her death. Consenting spouses (and their executors) should also watch for unexpected joint and several liability for gift tax, and the possibility that the consenting spouse’s estate will not be able to deduct the gift tax liability under section 2053 of the Code. For the locus classicus on gift-splitting, see Zeydel, “A Boondoggle or a Bad Idea,” Journal of Taxation, Volume 106, Number 6 (June 2007).

3 Reg. 106706-18.

4 In addition, for simplicity, we use masculine pronouns to refer to the donor spouse.

5 I.R.C. § 2035(b).