Bloomberg Tax

Tax Management Estates, Gifts and Trusts Journal™

Potential Anti-Abuse Rules May Limit Use of the Temporarily Increased Gift Tax Exclusion

By Katie Lynagh[*]
Milbank LLP
New York, NY

BACKGROUND

For only the second time in its history, the unified gift and estate tax exemption amount is scheduled, under current law, to decline. The Tax Cuts and Jobs Act (TCJA), although it temporarily doubled the basic exclusion amount (BEA) from $5 million to $10 million, adjusted for inflation, also provided that the increased or "bonus" exclusion expires after 2025.[1] As explained below, the temporary increase created a computational question of whether taxable gifts that use up the bonus exclusion before 2026 will effectively still be taxed at death if the donor dies after 2025. The Treasury Department and the IRS have now provided by regulation that the answer, generally speaking, is no: lifetime taxable gifts that are shielded against tax by the gift tax exclusion will successfully lock in any higher exclusion amount available during lifetime, even if the exclusion amount is lower at the time of the donor's death.[2]

By contrast, to the surprise of some, Treasury and the IRS have also announced that not all gifts will successfully preserve the bonus exclusion amount. In the preamble to final regulations on the effect of using up the bonus exclusion amount (the "anti-clawback regulations"), Treasury and the IRS announced that they have reserved space for "anti-abuse" rules. These contemplated anti-abuse rules are targeted, according to the preamble, at gifts that are pulled back into the donor's gross estate at death and/or that exploit the valuation rules of chapter14 of the I.R.C. in order to artificially increase the value of a donor's gift. As no anti-abuse regulations have yet been proposed, the scope of possible future anti-abuse rules is necessarily unclear. This article addresses what the anti-abuse rules might attempt to do, and how taxpayers and their advisors can plan in the meantime.

MECHANICS OF THE ANTI-CLAWBACK REGULATIONS

In order to understand the mechanics of the anti-clawback regulations, one must first understand the mechanics of estate tax calculations. The need for an anti-clawback rule arises because, in the estate tax computation procedures, lifetime gifts are added back into the estate tax base. In particular, §2001(b)(1)[3] provides that tentative estate tax is first computed on the sum of the decedent's taxable estate and the decedent's post-1976 adjusted taxable gifts, i.e., taxable gifts other than those that are already included in the gross estate. In other words, any gift made after 1976 is included in the estate tax base, either because it is

[*] Katie Lynagh is an associate in the Trusts and Estates Group of Milbank LLP and the Chair of the Estate and Trust Administration Committee of the New York State Bar Association's Trusts and Estates Law Section. She has written previously for the Trusts and Estates Law Section Journal of the New York State Bar Association and the New York Law Journal among other publications. The views expressed herein are her own.

The author would like to thank Austin Bramwell for his valuable advice and comments on this article.

[1] Pub. L. No. 115-97.

[2] Estate and Gift Taxes; Difference in the Basic Exclusion Amount, T.D. 9884, 84 Fed. Reg. 64,995, 64,996 (Nov. 26, 2019) (to be codified at 20 C.F.R. pt. 20) (hereinafter, "Preamble").

[3] All section references herein are to the Internal Revenue Code of 1986, as amended (the "Code"), or the Treasury regulations promulgated thereunder, unless otherwise indicated.

included in the gross estate[4] or, if not included in the gross estate, as an ''adjusted'' taxable gift.

The inclusion of post-1976 taxable gifts in the estate tax base does not mean, however, that those gifts are taxed twice. Rather, the inclusion is essentially a computational device for ensuring that a decedent's cumulative wealth transfers, whether made during lifetime or at death, are taxed at the progressive rates that exist at the decedent's death.[5] Double taxation is avoided, first, by §2010, which restores at death the entire amount of the decedent's gift and estate tax exclusion. Thus, the inclusion of taxable gifts in the estate tax base has the effect, first, of using up the decedent's estate tax exclusion amount.

Second, if the decedent paid or was liable for gift tax on taxable gifts, double taxation at death is avoided by the equivalent of a credit available to the estate for gift taxes payable on lifetime gifts. In particular, §2001(b)(2) subtracts from the tentative estate tax the gift tax that would have been payable with respect to post-1976 gifts made by the decedent, calculated at the estate tax rates in effect at the time of the decedent's death (hereinafter, the ''gift tax payable''). Thus, despite the inclusion in the estate tax base of gifts on which a decedent may have already paid tax, the gifts are not taxed twice; rather the gift tax payable is subtracted from the estate tax generated by the inclusion of the same gifts.[6]

In the wake of TCJA, the computation procedures created the possibility that taxable gifts that were shielded from gift tax by the temporarily increased exclusion amount under §2010 would effectively still be taxed at death if the donor died after 2025. The reason is that those gifts, as discussed, are added into the estate tax, either because they are included in the gross estate or as adjusted taxable gifts. Section 2001(b)(2), however, only allows the equivalent of a credit for gift taxes payable; there is no credit under §2001(b)(2) for a gift made before 2026 that is protected against tax by the bonus exclusion amount, as no gift tax would actually be owed on that gift. In other words, gifts that use up the bonus exclusion amount would potentially be added to the estate tax base but without an offsetting credit, thereby effectively generating an estate tax on those gifts at the donor's death if the donor dies in a year when the exclusion amount is less than it was at the time of the gifts.

Mindful of the potential for clawback,[7] Congress enacted §2001(g)(2) as part of TCJA. Section 2001(g)(2) directs Treasury to prescribe regulations necessary or appropriate to carry out §2001 ''with respect to any difference between . . . the basic exclusion amount under section 2010(c)(3) applicable at the time of the decedent's death, and . . . the basic exclusion amount under such section applicable with respect to any gifts made by the decedent.''[8] Exercising this authority, Treasury and the IRS have issued final anti-clawback regulations in order to ensure that gifts that use up the bonus exclusion amount are not effectively taxed at death. The anti-clawback regulations achieve this result by increasing the exclusion amount of a decedent whose gifts used up an exclusion amount that was higher at the time of the gifts. Technically, as the applicable exclusion amount is equal to the sum of two amounts – the basic exclusion amount or ''BEA'' available to all citizens and residents and any deceased spousal unused exclusion (DSUE) inherited from a predeceased spouse, only the BEA is increased. Thus, if the BEA that applies to the decedent's post-1976 gifts exceeds the BEA available at death (as would be the case if an individual made gifts that used up his bonus exclusion and then died in 2026), the estate tax is computed using the BEA that was used up during lifetime.[9]

LOCKING IN THE BONUS EXCLUSION WITH ARTIFICIAL GIFTS

As discussed, under the anti-clawback regulations, the bonus exclusion is locked in as long as the gifts made by the decedent use up an amount of BEA that exceeds the BEA available at the time of the decedent's death. It is irrelevant, under the final anti-clawback regulations, whether the gifts that used up the bonus exclusion are included in the decedent's gross estate at death, as would be the case with gifts in which the donor continues to enjoy the benefits of the gifted property. Gifts that are pulled back into the donor's gross estate at death are sometimes referred to as ''artificial gifts'' because, while they result in a taxable gift that may use up a donor's exclusion amount,

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[4] A gift made during lifetime may be included in the gross estate, for example, because the decedent retained sufficient control or beneficial interests to cause gross estate inclusion under one of the estate tax ''string'' provisions of §2036-§2039 or §2042.

[5] The unified credit under §2010 is now large enough that the progressive rates rarely have an effect. Instead, except for nonresident noncitizens, the gift and estate taxes are effectively imposed at a flat rate of 40% on wealth transfers that exceed the exclusion amount.

[6] Section 2001(g)(1) provides that the gift tax payable is computed using the rates in effect at death. Thus, if the decedent paid gift tax a rate that was higher than the rates in effect at death, the credit is still limited to the lower hypothetical tax that would have been paid at the lower rates in effect at death. *See Estate of Frederick R. Smith*, 94 T.C. 872 (1990).

[7] Joint Comm. on Taxation, *General Explanation of Public Law 115-97*, JCS-1-18 at 89 (Dec. 20, 2018), *available at* https://aboutbtax.com/Qsf.

[8] §2001(g).

[9] Reg. §20.2010-1(c), §20.2010-1(c)(2)(i) *Ex.* 1.

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the donor still retains sufficient interest or control to cause it to be included in the donor's gross estate. For example, a parent could make a gift of a remainder interest in property to his or her child and retain the right to the income and enjoyment of the property during the parent's lifetime. Due to the parent's retained interest in the property, the property would be included in the parent's gross estate pursuant to §2036(a)(1).

Under TCJA and the anti-clawback regulations, individuals now have an incentive to make artificial gifts, notwithstanding that they are included in the gross estate at death. By making gifts that use up the bonus exclusion before it disappears at the end of 2025, individuals can effectively increase the exclusion amount available upon death. Artificial gifts are particularly appealing to individuals whose asset levels are high enough that they are concerned about gift and estate taxes (thus they wish to use the bonus exclusion amount while it is still available), but who may not be comfortable parting with assets during their lifetimes without the ability to continue to benefit from them.

Not only are artificial gifts a potentially attractive way to lock in bonus exclusion without surrendering the benefits of ownership, but the special valuation rules under chapter 14 of the I.R.C., which were originally designed to curb abuses, can now be exploited in order to make it easier to lock in the bonus exclusion. In general, chapter 14 artificially increases the value of certain gifts. For example, if a parent transfers a remainder interest in property to his or her child and the parent retains a life estate, under the chapter 14 special valuation rules, the value of the parent's gift will equal the value of the property (not just the value of the remainder interest). The harsh effects of the chapter 14 special valuation rules may have previously caused individuals to steer clear of artificial gifts; however, chapter 14 has now become a friend to individuals who wish to make very large gifts to lock in the bonus exclusion amount before it becomes unavailable at the end of 2025.

POTENTIAL ANTI-ABUSE RULES

In its report on the 2018 proposed anti-clawback regulations (the "NYSBA Tax Section Report"), the New York State Bar Association Tax Section brought to Treasury's attention the possibility that individuals could make painless artificial gifts and yet still successfully lock in the bonus exclusion amount.[10] The NYSBA Tax Section Report suggested that Treasury consider reserving for the future, rules that could curb the use of artificial gifts to lock in the bonus exclusion. In the final anti-clawback regulations, Treasury adopted nearly all of the NYSBA Tax Section Report's recommendations, including to reserve space for rules that would address artificial gifts. In the preamble to those regulations, Treasury stated that "[t]he purpose of the special [anti-clawback] rule is to ensure that bona fide inter vivos transfers are not subject to inconsistent treatment for estate tax purposes" and reserved for future "anti-abuse" rules that could "prevent the application of the special [anti-clawback] rule to transfers made during the increased BEA period that are not true inter vivos transfers, but rather are treated as testamentary transfers for transfer tax purposes."[11] As recommended, Reg. §20.2010-1(c)(3) has been reserved for future possible anti-abuse rules.

AUTHORITY FOR ANTI-ABUSE RULES

Some might question whether Treasury has the authority to issue anti-abuse rules. After all, nothing in the estate tax computation procedures suggests that there should be a different computation depending on whether taxable gifts made during lifetime are included in the gross estate or not. In both cases, the gifts are included in the estate tax base; in both cases, any gift tax payable will be subtracted from the estate tax; and in both cases, the applicable exclusion amount is restored at death. In doctrinal terms, some might argue that a special rule targeting artificial gifts would be invalid under step two of the *Chevron*[12] test as an unreasonable interpretation of the estate tax computation procedures. In the author's view, however, such criticisms are unfounded and anti-abuse regulations are within the authority that Congress granted Treasury under §2001(g)(2). Section 2001(g)(2) provides that Treasury is directed to prescribe regulations necessary or appropriate to carry

[10] New York State Bar Association Tax Section Report, *available at* https://nysba.org/NYSBA/Sections/Tax/Tax%20Section%20Reports/Tax%20Section%20Reports%202019/1410%20Report.pdf.

[11] Preamble at 64,997. Treasury's use of the term "anti-abuse" is unusual in that existing anti-abuse rules normally apply substance-over-form principles. Substance-over-form principles are typically invoked in response to a taxpayer who attempts to re-characterize a transaction to achieve a more desirable result under the I.R.C. and Treasury regulations. An artificial gift, on the other hand, is a straightforward application of existing law that achieves exactly what it purports to do. Also, it would be logically inconsistent for Treasury to consider artificial gifts an abuse when they are used to lock in the bonus exclusion amount when Treasury has not previously considered artificial gifts an abuse when they are used to lock in the exclusion amount available to individuals pre-TCJA. Congress, or, where authorized, Treasury, is free to modify the gift and estate tax treatment of artificial gifts, but any such modification would be better characterized as a policy shift instead of as a curbing of perceived abuses of existing law.

[12] *Chevron U.S.A., Inc. v. NRDC*, 467 U.S. 837 (1984).

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out §2001 "with respect to any difference between . . . the basic exclusion amount under section 2010(c)(3) applicable at the time of the decedent's death, and . . . the basic exclusion amount under such section applicable with respect to any gifts made by the decedent."[13] Aware of Congress's apparent intent – albeit not expressed until after the legislation was passed[14] – to prevent clawback of gifts using the bonus BEA, some may view the section as merely a directive to Treasury to issue anti-clawback regulations (which Treasury has done); however, §2001(g)(2) is actually a much broader grant of legislative-type authority that leaves open a wide range of possible changes to the regulations governing estate tax computations, including, potentially, far-reaching rules that would create exceptions to the anti-clawback regulations. Commenters who point to the mechanical rules in the statute and argue that Treasury may not carve out policy-based exceptions ignore that §2001(g)(2) gives Treasury essentially legislative authority to create new rules not stated in the I.R.C.

POTENTIAL TARGETS OF ANTI-ABUSE RULES

In the preamble to the final anti-clawback regulations, Treasury notes that the potential new anti-abuse rules under consideration originated from comments (from the NYSBA Tax Section Report) that suggested targeting "transfers made during the increased BEA period that are not true inter vivos transfers, but rather are treated as testamentary transfers for transfer tax purposes", including, for example, "transfers subject to a retained life estate or other retained powers or interests, and certain transfers within the purview of chapter 14 of subtitle B of the Code."[15] The preamble later provides that "an anti-abuse provision could except from the application of the special [anti-clawback] rule transfers where value is included in the donor's gross estate at death."[16] These brief and fairly broad statements leave open many uncertainties regarding the potential anti-abuse rules, including, for example, whether the rules would apply to all transfers that are included in the gross estate, or only those transfers that are included in the gross estate *and* trigger the chapter 14 special valuation rules. The potential scope of the exception-based rules contemplated by Treasury can be better understood by reviewing the NYSBA Tax Section Report recommendations on which Treasury's potential anti-abuse rules are based.

The NYSBA Tax Section Report suggested that potential anti-abuse rules could disallow the use of the following types of gifts to lock in the bonus exclusion amount:

- **Grantor-Retained Income Trusts (GRITs)**- The final regulations provide that "transfers subject to a retained life estate or other retained powers or interests" could potentially be targeted by the anti-abuse rules.[17] As explained in the NYSBA Tax Section Report, when a donor makes a gift of a remainder interest while retaining a life estate, under §2036(a), the entire value of the property will be included in the gross estate of the donor.[18] When a donor creates a GRIT, he makes an irrevocable transfer of assets to the GRIT and retains an interest in the trust assets for a specified period of time. If the remainder beneficiary is the donor's spouse or certain family members and if the interest retained by the donor is not a qualified interest (as defined in the chapter 14 special valuation rules), the interest retained by the donor is valued at zero, resulting in a taxable gift amount equal to the total value of the property transferred from the donor to the GRIT.[19] Under the current I.R.C. and regulations, without anti-abuse rules, a GRIT would be an effective method of locking in the donor's bonus exclusion amount while still allowing the donor to benefit from the assets during his lifetime.

- **Intentionally Busted Preferred Partnership-** As explained in the NYSBA Tax Section Report, a donor can make a taxable gift by transferring common interests in a partnership or corporation to a family member and retaining certain types of preferred interests that "intentionally run afoul of the valuation rules of section 2701."[20] If the donor retains a preferred interest, such as a non-cumulative preferred annual payment, that does not meet an exception to the adverse valuation

[13] §2001(g).

[14] See Joint Comm. on Taxation Report, above, Note 7. The use of legislative history, in particular, committee reports, as a tool of statutory interpretation is controversial. Committee reports are viewed by some as the most authoritative type of legislative history. *See Dig. Realty Tr., Inc. v. Somers*, 138 S. Ct. 767, 782 (2018) (Sotomayor, J., concurring). However, committee reports can be unreliable in that they do "not necessarily say anything about what Congress as a whole thought." *Wis. Pub. Intervenor v. Mortier*, 501 U.S. 597, 620 (1991) (Scalia, J., concurring). *See also Circuit City Stores v. Adams*, 532 U.S. 105 (2001).

[15] *See* Preamble at 64,997.

[16] *See* Preamble at 64,997.

[17] *See* Preamble at 64,997.

[18] NYSBA Tax Section Report, paragraph F.

[19] §2702(a)(2)(A). For the definition of "member of the family," *see* §2702(e) and §2704(c)(2). For the definition of a "qualified interest," see §2702(b).

[20] NYSBA Tax Section Report, paragraph F.

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rules of §2701, the "subtraction method"[21] will be used to value the common interest and the retained preferred interest will be valued at zero, resulting in an artificially high valuation of the gifted common interest.[22] At the donor's death, the retained preferred interest (but not the gifted common interest) is included in his or her gross estate.

But that does not mean the value of the preferred interest is effectively taxed twice – once at the time of the gift, when the common interest's value is artificially increased by the value of the preferred interest, and a second time when the preferred interest is included in the donor's estate at death. On the contrary, the mitigation rule of Reg. §25.2701-5 prevents double taxation upon the donor's death by reducing the adjusted taxable gifts of the decedent by the lesser of: (1) the amount by which the decedent's taxable gifts were increased as a result of §2701 at the time of the initial transfer or (2) the value of the retained interest in the decedent's gross estate.[23] Thus, only the "true" value of the common interest is added into the estate tax base at death, not its artificially increased gift tax value.

Given the expiring bonus exclusion amount, however, the mitigation rules create the possibility of using a preferred partnership in order to make taxable gifts that use up gift tax exclusion but without surrendering income or control. The intentionally busted partnership gifting strategy is different from other types of "abusive" gifts in that the property that the donor gifts is not included in the donor's gross estate; however, the preamble to the final anti-clawback regulations leaves it unclear just how far Treasury's anti-abuse rules could go. The NYSBA Tax Section Report suggests that Treasury and the IRS propose amending the mitigation rule to provide that if a donor uses his or her bonus exclusion to make a gift to which the §2701 special valuation rules apply, the amount of bonus exclusion used up by the §2701 gift should be subtracted from the amount by which the adjusted taxable gifts of the decedent is reduced pursuant to the mitigation rule.[24] In the alternative, Treasury could deny use of the bonus exclusion on gifts to which §2701 applied by providing that, when calculating the BEA based credit used up during lifetime for purposes of Reg. §20.2010-1(c), no credit would be allowed with respect to the portion of a gift that was artificially increased by operation of §2701 (i.e., in this example, the value of the preferred interest retained by the donor). Either of these potential rules would prevent the use of the intentionally busted partnership strategy to lock in the bonus exemption; however, under the current I.R.C. and regulations, without anti-abuse rules, the gift of a common interest in an intentionally busted partnership would be an effective method of locking in the donor's bonus exclusion amount while still allowing the donor to benefit from the assets during his lifetime.

While it is clear from the preamble to the final anti-clawback regulations and the NYSBA Tax Section Report that the anti-abuse rules, if adopted, would likely target gifts that are pulled back into the gross estate of the donor and/or gifts to which the chapter 14 special valuation rules apply, there are still many open questions as to the scope of the potential anti-abuse rules, including the following:

- **Extension to Gifts Approved by Statute and Regulation**- If the anti-abuse rules prohibit the locking in of the bonus exclusion via a GRIT, would Treasury go so far as to attack other similar strategies that have, to date, enjoyed statutory and administrative blessing? Gifts to a qualified personal residence trust (QPRT) or to a grantor retained annuity trust (GRAT) are statutorily approved techniques, and Treasury has even supplied taxpayers with a QPRT form that contains an embedded GRAT form.[25] If Treasury exempts QPRTs from the potential anti-abuse rules, it may then have trouble distinguishing a QPRT from a GRAT. A QPRT is essentially a GRIT that is statutorily exempted from the chapter 14 special valuation rules.[26] When a donor creates a QPRT, he or she transfers a personal residence to the QPRT and retains the right to use the home for a specified period of time.[27] Likewise, when a donor creates a GRAT, he or she transfers property to the GRAT and retains an annuity interest for a specified period of time.[28] Because the donor's retained interest is valued using normal valuation rules, the donor's gift is equal to the value of the remainder interest. As with a GRIT, if the donor dies holding a retained interest the QPRT or GRAT will be included in the donor's gross estate. In both cases, the donor can make a taxable gift and effectively retain the income and enjoy-

[21] Reg. §25.2701-3.

[22] Reg. §25.2701-2(a)(2).

[23] Reg. §25.2701-5.

[24] NYSBA Tax Section Report, paragraph F.

[25] Rev. Proc. 2003-42.

[26] §2702(a)(3)(A)(ii).

[27] See Reg. §25.2702-5(c) for the requirements for a valid QPRT.

[28] See Reg. §25.2702-3 for requirements applicable to GRATs.

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ment of transferred property for the donor's lifetime. Treasury will need to make a policy judgment as to whether QPRT and GRAT gifts should be protected from the harsh treatment of the anti-abuse rule.

- **Gifts That Use Up DSUE or Original Exclusion**- Based on the final anti-clawback regulations and the NYSBA Tax Section Report, the potential anti-abuse rules are intended to target certain gifts that take advantage of the bonus exclusion that is available only temporarily. It is unclear whether the same policy applies to gifts that merely use up the ''base'' exclusion amount that will remain available even after 2025. Likewise, it is unclear whether the same policy applies to gifts that use up any DSUE inherited from a prior deceased spouse. Under portability regulations that govern the application of the DSUE, if a surviving spouse makes an artificial gift that uses up DSUE and later remarries and survives a second spouse, the artificial gift will successfully lock in the DSUE inherited from his or her first spouse despite the ''last deceased spouse'' rule that generally causes DSUE inherited from the first spouse to be lost. In other words, Treasury has already approved artificial gifts in the portability context.[29] If Treasury creates anti-abuse rules that prevent the use of artificial gifts to lock in the bonus BEA, will it also, for the sake of policy consistency, impose an ''anti-abuse'' exception in the portability regulations? Or, could Treasury take the approach of deeming artificial gifts acceptable only to the extent that they use up the BEA that was available prior to TCJA and will continue to be available after 2025 (the ''original exclusion'') or the DSUE inherited from a deceased spouse? Under the final anti-clawback regulations, an individual's bonus exclusion is not applied to gifts until the individual's entire original exclusion amount and DSUE are used up; thus, unless the anti-abuse rules cover all types of gifts (*i.e.*, gifts that use up the bonus exclusion, DSUE, and the original exclusion), it is possible that a gift made prior to 2026 could be partially subject to the anti-abuse rules and partially exempt from the anti-abuse rules.[30]
- **Gifts by Promise**- A gift by promise is a gifting strategy in which the donor promises to transfer assets to donees in the future. The gift is a taxable gift as long as the promise is enforceable under local law and made for less than full and adequate consideration in money or money's worth, and, under the computation procedures of §2001(b), the gift should not be included in the gross estate.[31] The reason for this is that, as Rev. Rul. 84-25 explains, to the extent that the note remains unpaid at the time of the donor's death, the assets that are to be used to satisfy the note are a part of the donor's gross estate and the value of the gift is not included in the donor's adjusted taxable gifts when computing the tentative estate tax under §2001(b).[32] Neither the final anti-clawback regulations nor the NYSBA Tax Section Report specifically mentions gifts by promise, but it is possible that gifts by promise could be targeted by the anti-abuse rules because they are included in the gross estate of a donor under §2033 (however, the donor retains no gross estate inclusion ''string'' under §2036, §2038, or §2042).

DEATHBED PLANNING

Will the potential anti-abuse rules address gifts that are saved from gross estate inclusion via deathbed planning? The NYSBA Tax Section Report notes that deathbed planning could be used to circumvent a potential anti-abuse rule that targets gifts included in the estate of a decedent.[33] The I.R.C. contains a mechanism to combat deathbed planning: §2035(a) pulls property into the gross estate of a decedent if the decedent relinquished certain rights or powers within three years of death. However, §2035(a) is relatively narrow and there are multiple estate planning strategies, including the following, that can be used to circumvent it:

- **Expunging a Gross Estate Inclusion String**- As noted in the NYSBA Tax Section Report, affirmative relinquishment on the part of the donor is required to trigger §2035(a). Thus, if a third party is given the power to eliminate the donor's retained interest and the third party eliminates such retained interest prior to the donor's death, the relinquished interest is not included in the gross es-

[29] For a comprehensive discussion, see Bramwell and Socash, *Preserving Inherited Exclusion Amounts: The New Planning Frontier*, Real Property, Trust and Estate Law Journal, Vol. 50, No. 1 (Spring 2015).

[30] For an analysis of the final anti-clawback regulation computational rules and a strategy for increasing the exclusion amounts, see Bramwell and Lynagh, How to Increase Estate Tax Exclusion Without Using Up Bonus BEA, LISI Estate Planning Newsletter #2770 (Dec. 19, 2019).

[31] For a thorough discussion of the gift by promise strategy, see Bramwell, *The Gift-by-Promise Plan Works as Advertised,* LISI Estate Planning Newsletter #2033 (Dec. 3, 2012); Bramwell and Mullen, *Donative Promise Can Use Up Gift Tax Exemption*, LISI Estate Planning Newsletter #2001 (Aug. 23, 2012); Bramwell, Donative Promise Can Lock In 2012 Gift Tax Exemption, Estate Planning, Vol. 39, No. 8.

[32] Rev. Rul. 84-25.

[33] NYSBA Tax Section Report, paragraph F.

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tate and §2035(a) is effectively circumvented.[34] This strategy could be used to prevent the inclusion of a GRIT (discussed above) in the gross estate of the donor. Therefore, unless deathbed planning is addressed in the anti-abuse rules, GRITs may remain an effective strategy for making gifts that use up the bonus exclusion and allow the donor to continue to benefit from the gifted property during his or her lifetime.

- **Satisfaction of a gift by promise**- If a donor satisfies a gift by promise (discussed above) prior to his death, the assets that he uses to satisfy the note will not be included in his gross estate, and his satisfaction of the note will be considered a satisfaction of an obligation as opposed to a gift. If the note is held by an irrevocable trust that is treated as a grantor trust with respect to the donor for income tax purposes, the donor could even satisfy the note in-kind by transferring assets to the irrevocable trust without recognition of gain (although a donor who is engaging in ''deathbed'' planning may instead prefer for highly appreciated assets to be included in his estate so that the basis of each such asset is stepped up to fair market value upon his death).

Given that §2035(a) can be avoided in some cases, will Treasury consider denying the benefit of the anti-clawback rules even in situations where §2035(a) does not cause gross estate inclusion? While it might be relatively difficult to draft anti-abuse rules that are specific enough to curb the use of the aforementioned deathbed planning strategies to lock in the bonus exclusion, it would be well within Treasury's broad authority under §2001(g) to create such rules.

PLANNING WITH ANTI-ABUSE RULES IN MIND

There is no guarantee that Treasury will follow through with proposing and finalizing anti-abuse rules as it suggested it would do in the preamble to the final anti-clawback regulations, especially considering that Treasury has often been slow to issue gift and estate tax regulations. Significant regulations that have not yet been issued include final regulations regarding the basis consistency and information reporting requirements of §1014(f) and §6035 (following enactment of these sections in 2015)[35] and final regulations on the tax on covered gifts and bequests imposed by §2801 (following enactment of §2801 in 2008).[36] Even regulations that Treasury prioritizes for completion within a year are typically not completed on schedule; for example, ''anti-*Kohler*''[37] regulations under §2032(a), which have not yet been issued, were first included in Treasury's 2007-2008 Priority Guidance Plan[38] and are included in Treasury's 2019-2020 Priority Guidance Plan.[39] However, while it is possible that anti-abuse regulations may never be issued, caution would suggest that practitioners should advise clients of the potential for anti-abuse rules and offer clients estate planning strategies that are not expected to be targeted by any such rules.

Married couples who wish to lock in the bonus exclusion have a wider range of estate planning strategies available to them. As discussed below, married couples can create a Spousal Lifetime Access Trust (SLATs). In addition, the surviving spouse of an individual who dies before 2026 can lock in the predeceased spouse's bonus exclusion by credit shelter planning or a simple portability election.[40] The final anti-clawback regulations reaffirmed the favorable rule that the DSUE that passes to a surviving spouse is limited to the BEA available at the time of the death of the first spouse to die instead of to the (potentially lower) BEA available at the death of the surviving spouse. Thus, all moderately wealthy couples should plan to elect portability in the event that a spouse dies before 2026.

The viability of some types of gifts is dependent on the extent to which Treasury takes a more nuanced approach, as compared to a broad approach, in drafting the anti-abuse rules. For example, if the anti-abuse rules target only gifts that are included in the gross estate and do not make tailored exceptions that address deathbed planning such as the strategies for expungement of a donor's retained interest in a GRIT and/or satisfaction of a gift by promise, these strategies will continue to be viable methods for locking in the bonus exclusion. On the other hand, it is possible that anti-abuse rules could target deathbed planning, even if it successfully avoids gross estate inclusion under

[34] The IRS has acknowledged in non-binding rulings that §2035(a) is not triggered by the automatic termination of a donor's property right pursuant to its terms or a termination of a power due to events outside of the control of the donor. PLR 9032002, 9109033.

[35] Surface Transportation and Veterans Health Care Choice Improvement Act, Pub. L. No. 114-41.

[36] Heroes Earnings Assistance and Relief Act, Pub. L. No. 110-245.

[37] *See Kohler v. Commissioner*, T.C. Memo 2006-152, *nonacq.*

[38] Department of the Treasury 2007-2008 Priority Guidance Plan (Update) (Apr. 22, 2008), *available at* https://www.irs.gov/pub/irs-utl/2007-2008pgp.pdf.

[39] Department of the Treasury 2019-2020 Priority Guidance Plan (Second Quarter Update) (Mar. 6, 2020), *available at* https://www.irs.gov/pub/irs-utl/2019-2020_pgp_2nd_quarter_update.pdf.

[40] See §2010(c) for rules governing the portability election.

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§2035. Thus, any strategy that involves circumventing §2035(a) is potentially vulnerable to future anti-abuse rules. Paradoxically, the vulnerability could exist even if the IRS is unable to include the artificial gift in the gross estate under §2035.

In general, to avoid running afoul of the potential anti-abuse rules, individuals should make gifts that do not trigger the chapter 14 valuation rules and that are not pulled into the donor's gross estate. Artificial gifts are appealing in that they allow a donor to use his or her bonus exclusion while still maintaining access to the gifted property, however, a donor can accomplish these goals more safely through the following gifting strategies that are not expected to be targeted by the potential anti-abuse rules:

> **(i) SLAT**- A SLAT is a trust for the benefit of a donor's spouse and/or descendants or other persons or organizations. The donor's gift to the SLAT must be a completed gift in order to use up the donor's bonus exclusion.[41] Typically, distributions of income and/or principal may be made to the donor's spouse[42] in the discretion of a trustee who is neither the donor nor the donor's spouse (but who can be removed by the donor or the donor's spouse). The assets contributed to the SLAT are protected from the donor's creditors and the ability for the donor's spouse to receive distributions is a safety net without which some donors may not be comfortable making a significant gift of assets. When considering a SLAT, it is important to consider the following attributes of a SLAT: (a) the SLAT only serves as a safety net for the donor while the donor is married and the donor's spouse is living (however, the SLAT could support the donor by making loans to the donor), (b) generally, because the donor's spouse is a beneficiary of the trust, the donor and the donor's spouse cannot split gifts to the SLAT, and (c) because the donor's spouse is a beneficiary, the SLAT will be a grantor trust for income tax purposes, meaning that the donor will be responsible for the trust's income taxes (although the donor's spouse can receive distributions from the SLAT that the donor can use to pay taxes). Some married individuals choose to create SLATs for each other's benefit in order to make use of both spouses' exclusion amounts and ensure that, regardless of which spouse dies first, the surviving spouse will have a SLAT from which to benefit.[43] When both spouses create SLATs, some key terms of the trusts should differ from each other so that the trusts are not included in the donors' estates under the reciprocal trust doctrine.
>
> **(ii) Trust with Broad Special Power of Appointment**- Another option for a donor who does not wish to make a gift without a safety net that allows him to access the assets in the future is for the donor to fund a trust for the benefit of his descendants and/or other persons and organizations the terms of which grant someone (a ''power holder'') a broad special power of appointment over the assets of the trust. The power holder could exercise his special power of appointment in favor of a trust for the donor's benefit (the ''appointed trust''), enabling the trust assets to flow back to the donor. For the trust assets to be protected from the creditors of the donor, the trust created by the donor and the appointed trust should be created under the laws of a state that allows for self-settled trusts to be protected from the claims of creditors. To minimize the risk of gross estate inclusion under §2036(a)(1), care should be taken to avoid any ''understanding, express, or implied'' that the donor may later benefit from the trust.[44]

CONCLUSION

The final anti-clawback regulations are a much-welcomed modification to the estate tax computation rules in that the rules confirm that, generally, lifetime taxable gifts that are shielded against tax by the gift tax exclusion will successfully lock in any higher exclusion amount available during lifetime, even if the exclusion amount is lower at the time of the donor's death. This paves the way for individuals to make gifts that use up the bonus exclusion amount before it becomes unavailable at the end of 2025; however, anyone considering such gifts should keep in mind that Treasury has reserved for potential ''anti-abuse''[45] rules that may curb the use of certain gifting strategies – in particular, strategies that allow the donor to continue to benefit from the gifted property – to lock in the bonus exclusion. The potential anti-abuse rules could limit a donor's ability to lock in the temporarily available bonus exclusion amount by

[41] A donor in a community property state should fund the SLAT with his or her separate property in order to prevent inclusion of the SLAT in the gross estate of the beneficiary spouse.

[42] In a well-drafted SLAT, the beneficial interests of the spouse are typically severed in the event of a separation or divorce. The SLAT could also include as a beneficiary any future spouse of the donor.

[43] For an analysis of the merits of gift splitting for married individuals who intend to use up the bonus exclusion of one or both spouses, see Bramwell and Lynagh, *The Paradoxical New Gift Splitting Calculus*, LISI Estate Planning Newsletter #2713 (Apr. 1, 2019).

[44] Reg. §20.2036-1(c)(1)(i).

[45] *See* Preamble at 64,997.

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making gifts that are pulled back into the donor's gross estate at death and/or that exploit the valuation rules of chapter14 of the I.R.C. in order to artificially increase the value of a donor's gift. Although the full scope of these potential anti-abuse rules is necessarily unclear until any such rules are proposed, it is possible that the anti-abuse rules could prevent the use of GRITs and/or gifts of common interests in intentionally busted preferred partnerships to lock in the bonus exclusion. If Treasury moves forward with proposing anti-abuse regulations, it will need to make policy decisions as to whether the anti-abuse rules would affect estate tax calculations for gifts that use up the DSUE or the original exclusion amount and/or gifts using statutorily-blessed techniques such as GRATs and QPRTs. In the meantime, until anti-abuse rules are proposed, individuals who wish to use up the bonus exclusion while maintaining a degree of access the gifted property should consider gifting strategies such as SLATs and trusts with broad special powers of appointment in lieu of the strategies that may be targeted by the potential anti-abuse rules.

ISSN 0886-3547