IRS ISSUES PROPOSED REGULATIONS CLARIFYING ANTI-CLAWBACK RULES FOR RETAINED INTEREST GIFTS

April 29, 2022

In November of 2019, the IRS issued final regulations referred to as the “Anti-Clawback” regulations that made it clear that a taxpayer who took advantage of the higher gift tax exemptions (currently, $12,060,000) available under the 2017 Tax Cuts and Jobs Act would not owe additional estate tax upon death if the exemption is lower at the time of death. The regulation was needed since the estate tax calculation includes lifetime taxable gifts. Otherwise, a taxpayer who made a large gift now may not pay gift tax but the estate would pay estate tax upon the taxpayer’s death if the exemption was lower at that time.

On April 26, 2022, the IRS issued a proposed regulation that builds on the Anti-Clawback regulation to clarify that certain gifts in which the donor retained an interest (“Retained Interest Gifts”) cannot be used to try to take advantage of the higher exemption. This provision would apply to certain transactions purposely structured to try to use the increased exemption while retaining some use of the gifted assets, but also would apply to retained interest gifts such as grantor retained annuity trusts (GRATs), Qualified Personal Residence Trusts (QPRTs) and other techniques or promissory notes which are still outstanding at death   This means that Retained Interest Gifts will be included in the estate tax calculation based on the value at the time of death and the exemption at the time of death and rates would apply. A taxpayer cannot use these techniques to try to lock in the higher exemption and still have access to the gifted assets until their death.

The regulations have an exception for smaller Retained Interest Gifts where the gift is insignificant, meaning the gift is 5% or less of the total transfer. The regulations also included an 18 month rule to capture death bed planning. If a taxpayer gives up the retained interests within 18 months of, but prior to, death, those retained interests will still be included in the taxable estate at the then exemption and rates.

If you have any questions regarding these proposed regulations, please contact your Cummings & Lockwood LLC attorney.