FUTURE PERFECT: HOW TENSE AND MOOD WILL HAVE DECLAWED THE CLAW-BACK

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Editors' Synopsis: In its current form, the sunset provision of the Economic Growth and Tax Relief Reconciliation Act of 2001, section 901, as amended by section 101(a)(1) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (2010 Act), is sufficient, in itself, to prevent Internal Revenue Code section 2001(b)(1)'s inclusion of 2011 or 2012 gifts covered by the margin of the 2010 Act's $5 million "applicable exclusion amount" from generating an estate tax to be "clawed back" from donees of decedents who die in 2013 and later.

I. INTRODUCTION: THE SUPPOSED CLAW-BACK

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (2010 Act) created a two-year gift tax "applicable exclusion amount" of $5 million.[1] This represents what may be a brief opportunity for someone who will die in 2013 or later to reduce her estate tax base, without paying gift tax, by a $4 million margin that has not previously been, and under current legislation will not subsequently be, available. Practitioners have questioned the value of this opportunity, reasoning that post-

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[1] Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, sec. 302(a)(1), 124 Stat. 3301 (amending I.R.C. § 2010(c)).

2012 estate tax computations will include 2011 and 2012 gifts covered by the margin of the 2010 Act's $5 million applicable exclusion amount in a way that will generate an estate tax to be clawed back from a decedent's 2011 and 2012 donees. This article asserts that the claw-back is chimerical: on a careful reading of the relevant statutes, the sunset provision of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), as amended by the 2010 Act, is sufficient to prevent the computations hypothesized by proponents of the claw-back.

A recent article conveniently illustrates the supposed claw-back in a hypothetical case involving someone who made a $4 million dollar gift in 2011 and dies in 2013:

> Mrs. Widow has assets of $7 million after previously using her $1 million gift tax exemption. In 2011, she gives away another $4 million, leaving her with $3 million. She maintains the $3 million in assets for the next two years. Assume that Congress allows the sunset provisions in EGTRA [sic] and the 2010 Act to sunset. Based on the above statutory provisions (and the add-back of taxable gifts during her lifetime) the tax at her death would be $4,040,000 [sic] ($1,290,800 + $2,75,000 [sic] (($8,000,000 - $3,000,000) x .55)). However, the assets available are only $3 million, so the Internal Revenue Service . . . would "claw back" $1,040,800 from the gift recipients.[2]

The reference in this passage to "the add-back of taxable gifts" is to Internal Revenue Code (Code) section 2001(b)(1)(B), which includes in the estate tax base any taxable gift the decedent made after December 31, 1976, that is not includible in the decedent's gross estate.[3] The add-back is part of the computation of "a tentative tax,"[4] from which the estate tax is derived by subtracting pursuant to Code section 2001(b)(2), "the aggregate amount of tax which would have been payable under chapter 12 [i.e., the gift tax] with respect to gifts made by the decedent after December 31, 1976, if the

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[2] George W. Gregory, *An Overview of Estate Planning and Estate Administration Under the 2010 Tax Act: The "Clawback," Electing Out of the Federal Estate Tax, Electing to Pay the Generation-Skipping Transfer Tax for 2010 Because the Inclusion Ratio Is Zero, Portability Is Useful, but the Credit Shelter Trust Is Not Dead Yet*, MICH. PROB. & EST. PLAN. J., Spring 2011, at 4, 4.

[3] *See* I.R.C. § 2001(b) (2006).

[4] *Id.* § 2001(b)(1) (2006).

provisions of subsection (c) [i.e., the rate schedule] (as in effect at the decedent's death) had been applicable at the time of such gifts."[5]

II. POSITING A ZERO SECTION 2001(b)(2) SUBTRACTIVE FOR POST-SUNSET CALCULATIONS

The author of the passage quoted above evidently has assumed that for purposes of applying section 2001(b)(2) in 2013 (in the form in which that section will apply in that year) the "amount of tax which would have been payable under chapter 12"[6] on the 2011 gift of $4 million will be *zero*, for the amount of the estate tax described in the example just *is* the amount of the tentative tax computed under section 2001(b)(1).[7] Of course, what would justify that assumption is the application, for purposes of section 2001(b)(2) in 2013, of the full "applicable exclusion amount" that will actually have been available in 2011 to shelter the 2011 gift from gift tax—$4 million.[8] In that case, for purposes of the 2013 calculation, "the aggregate amount of tax which *would have been* payable under chapter 12"[9] on the 2011 gift would be the amount of gift tax the decedent will actually have paid on the 2011 gift—zero. That *would* yield $695,000 in estate tax ($1,040,800 before application of the $345,800 applicable credit amount described in section 2010(c))[10] to be clawed back from the decedent's

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[5] *Id.* § 2001(b)(2) (2006), *amended by* Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, sec. 302(a)(1), 124 Stat. 3301. Section 304 of the 2010 Act provides that the 2010 Act is subject to the EGTRRA's sunset provision. *See* Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, sec. 304, 124 Stat. 3304. The 2010 Act also amended EGTRRA's sunset provision (Amended EGTRRA Sunset Provision) to delay its effective date until December 31, 2012. *See id.* sec. 101(a)(1), 124 Stat. 3298. The Amended EGTRRA Sunset Provision requires that the Code be applied to estates of decedents dying after December 31, 2012, as if the amendments of the EGTRRA and the 2010 Act had never been enacted. *See* Economic Growth Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, sec. 901, 115 Stat. 150, *amended by* Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, sec. 101, 124 Stat. 3298; Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, sec. 304, 124 Stat. 3304.

[6] *Id.*

[7] *See* Gregory, *supra* note 2, at 4.

[8] I.R.C. § 2010(c).

[9] *Id.* § 2001(b)(2) (2006) (emphasis added).

[10] *See id.* § 2010(c) (2000), *amended by* Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 521(a), 115 Stat. 71, *and* Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, § 303, 124 Stat. 3302.

donees. The full computation on this zero-section 2001(b)(2)-subtractive-interpretation is shown in Table 1.

Table 1
BNA Estate and Gift Tax Planner[11] Calculation Assuming a $5 Million Total Applicable Exclusion Amount in 2011 for Estate Tax Computations in 2013

		Calculation 1
1	Date of Death	1/1/2013
2	Adjusted Gross Estate (AGE)	3,000,000
3	Marital Deduction	0
4	Charitable Deduction	0
5	Taxable Estate	3,000,000
6	After 1976 Taxable Gifts	5,000,000
7	Federal Estate Tax Base	8,000,000
8	Federal Tax Per Schedule	4,040,800
9	**After 1976 Gift Taxes**	**0**
10	Unified Credit	345,800
11	Federal Tax Net of Credit	3,695,000
12	State Estate Taxes–Maximum Credit	182,000
13	Federal Tax Before Special Credits	3,513,000
14	Special Federal Estate Tax Credits	0
15	Federal Tax	3,513,000
16	State Estate Taxes	182,000
17	Total Estate Taxes	3,695,000
18	**Family Share of AGE**	**-695,000**

[11] The BNA Estate & Gift Tax Planner (2011) was used to generate the figures in each of the Tables in this Article.

III. TENSE AND MOOD: LOCATING THE NON-ZERO SUBTRACTIVE BY CONJUGATION

The problem with the calculation in Table 1 and the illustration quoted at the outset is that the zero section 2001(b)(2) subtractive contradicts the Amended EGTRRA Sunset Provision.[12] The Amended EGTRRA Sunset Provision dictates that, for purposes of applying section 2001(b)(2) in 2013, the "amount of tax which *would have been* payable under chapter 12"[13] on the 2011 gift of $4 million *will have been* the amount of tax which "would have been payable under chapter 12" on that gift if the alterations of the section 2010(a) applicable credit amount effected by EGTRRA and the 2010 Act "had never been enacted."[14] If the alterations of the applicable credit amount effected by EGTRRA and the 2010 Act had never been enacted, *ceteris paribus*, the applicable exclusion amount for 2011 would be $1 million.[15]

A. Tense

Under the Amended EGTRRA Sunset Provision, for purposes of applying section 2001(b)(2) in 2013, the applicable exclusion amount for 2011 will have been $1 million, not $5 million. Thus, for purposes of the 2013 calculation, the "the aggregate amount of tax which would have been payable under chapter 12" on the 2011 gift will be $2,045,000.[16] This is shown on line 9 of the Calculation 2 column in Table 2.

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[12] *See* Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, sec. 901, 115 Stat. 150, *amended by* Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-132, sec. 101(a)(1), 124 Stat. 3298.

[13] I.R.C. § 2001(b)(2) (2006) (emphasis added).

[14] *See* Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, sec. 901, 115 Stat. 150, *amended by* Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-132, sec. 101(a)(1), 124 Stat. 3298.

[15] *See* I.R.C. § 2010(c) (2000).

[16] *See id.* §§ 2001(b)(2) (2006), 2010(c) (2000), 2001(c) (2000), *amended by* Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 511(a), 115 Stat. 70, *and* Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, § 302(a)(2), 124 Stat. 3301.

Table 2
BNA Estate and Gift Tax Planner Calculation Assuming a $1 Million Total Applicable Exclusion Amount in 2011 for Estate Tax Computations in 2013[17]

		Calculation 1	Calculation 2
1	Date of Death	1/1/2013	1/1/2013
2	AGE	3,000,000	3,000,000
3	Marital Deduction	0	0
4	Charitable Deduction	0	0
5	Taxable Estate	3,000,000	3,000,000
6	After 1976 Taxable Gifts	5,000,000	5,000,000
7	Federal Estate Tax Base	8,000,000	8,000,000
8	Federal Tax Per Schedule	4,040,800	4,040,800
9	**After 1976 Gift Taxes**	0	**2,045,000**
10	Unified Credit	345,800	345,800
11	Federal Tax Net of Credit	3,695,000	1,650,000
12	State Estate Taxes–Maximum Credit	182,000	182,000
13	Federal Tax Before Special Credits	3,513,000	1,468,000
14	Special Federal Estate Tax Credits	0	0
15	Federal Tax	3,513,000	1,468,000
16	State Estate Taxes	182,000	182,000
17	Total Estate Taxes	3,695,000	1,650,000
18	**Family Share of AGE**	-695,000	**1,350,000**

As Table 2 shows, the $2,045,000 section 2001(b)(2) subtractive leaves nothing to be clawed back from the decedent's donees. Furthermore, the $1,650,000 figure shown on line 17 of Table 2's Calculation 2 column is exactly the amount of the tax yielded by the marginal rate applicable to the assets in the adjusted gross estate.[18] Thus, the Calculation 2 section 2001(b)(2) subtractive completely offsets the effect of including the 2011 gift in the estate tax base.

B. Mood

Note that nothing in the preceding analysis is out of keeping with the usual interpretation of section 2001(b)(2). By its terms, that section describes a hypothetical tax, one "which would have been payable under chapter 12 with respect to gifts made by the decedent after December 31, 1976,

[17] The figures in Table 2 are generated by the BNA Estate & Gift Tax Planner (2011) where the tax is applied on a 2002 gift of $4 million as the section 2001(b)(2) subtractive.

[18] *See* I.R.C. § 2001(c) (2000) ($3,000,000 x 0.55 = $1,650,000).

if the provisions of [the rate schedule under section 2001(c)] (as in effect at the decedent's death) had been applicable at the time of such gifts."[19] The hypothetical aspect of the gift tax described in section 2001(b)(2) is not limited to the effective rate for section 2001(b) has regularly been interpreted to allow adjustments (in certain cases) to taxable gifts not included in the decedent's gross estate *regardless* of final determinations for gift tax purposes.[20] Thus, by retrospectively altering 2011's (and 2012's) applicable exclusion amount for purposes of applying section 2001(b)(2) in 2013 and beyond, the Amended EGTRRA Sunset Provision merely uses an antecedent facility to achieve the right computational result on the facts in question.

IV. CONCLUSION

The confluence of the Amended EGTRRA Sunset Provision's use of the past perfect tense in "had never been enacted"[21] and section 2001(b)(2)'s use of the subjunctive mood in "which would have been payable"[22] is sufficient to prevent section 2001(b)(1)'s inclusion of 2011 or 2012 gifts covered by the margin of the 2010 Act's $5 million applicable exclusion amount from generating an estate tax to be clawed back from thedonees of decedents who die in 2013 and beyond. By the time section 2001(b)(2) is applied to compute tax on the estate of any such decedent, the 2011 and 2012 applicable exclusion amounts, for purposes of applying section 2001(b)(2), will have been only $1 million. Therefore, section 2001(b)(2)'s subtraction of the "amount of tax which would have been payable under chapter 12"[23] on gifts made in 2011 and 2012 will completely offset the effect of the gifts' inclusion in the estate tax base and leave nothing to claw back.

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[19] *Id.* § 2001(b)(2) (2006).

[20] *See* Evanson v. United States, 30 F.3d 960, 963 (8th Cir. 1994) (applying I.R.C. § 2504(c), which prevents revaluation after the limitations period has run for gift tax purposes, but does not prevent a valuation increase in adjusted taxable gifts for estate tax purposes); *see also* Levin v. Comm'r, 986 F.2d 91, 93 (4th Cir. 1993); Estate of Smith v. Comm'r, 94 T.C. 872, 878 (1990); Estate of Prince v. Comm'r, 61 T.C.M. (CCH) 2594, 2594 (1991); Treas. Reg. § 20.2001-1(a); 5 BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS ¶ 132.3 (2d ed. 1993 & Supp. No. 2 2011).

[21] Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, sec. 901, 115 Stat. 150, *amended by* Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, sec. 101(a)(1), 124 Stat. 3298.

[22] I.R.C. § 2001(b)(2) (2006).

[23] *Id.*