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AALU Bulletin No: 11-13

February 2, 2011

**Subject: Claw Back Scenario Should Not Deter Planners in 2011 and 2012**

Major References: [\*\*\*"Tax Relief, Unemployment Insurance Authorization and Job Creation Act of 2010," P.L. 11-312, Title III, \(December 17, 2010\)\*\*\*](#)

Prior AALU Washington Reports: 11-06; 11-09; 10-135

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THE CONCLUSION OF THIS WASHINGTON REPORT.**

*In our Bulletin No. 11-09, we discussed the discussion that gifts made during 2011 and 2012 may, due in part to the way in which the current Form 706 (Federal Estate and Generation-Skipping Transfer Tax Return) is drafted, be subject to an estate tax in years following 2012 if the federal estate tax exemption is reduced at that time. This discussion is referred to here as the "claw back" scenario.*

*This Bulletin is intended to provide greater clarity around the "claw back" scenario. Our analysis indicates that clients should be confident in taking advantage of the increased gift and generation-skipping transfer tax exemptions available in 2011 and 2012 without undue concern that such gifts will be subject to a claw back in later years. In the meantime, as discussed in our Bulletin No. 11-09, and for the reasons stated therein, we believe that producers should be confident in working with their clients to ensure the maximum use of their exemptions during 2011 and 2012 despite the discussion around the claw back scenario.*

Confusion arose because (i) since the 1976 Tax Reform Act (when the estate and gift tax exemptions were first "unified") the concept of "adjusted taxable gifts" has been used to compute the amount of Federal

estate tax due on the taxable estate; and (ii) the rates of tax have never increased since the unified system has been in place. In essence, in the unified system, the amount of post-1976 taxable gifts is added to the taxable estate, the estate tax is computed on the total amount, and the gift tax previously paid (or deemed to be previously paid, pursuant to a computation in the Worksheets to the Form 706) is then backed out of the computation. If the tax rates used to compute both the estate tax and the gift tax deemed to be previously paid are the same, there should be no impact on the computation, either to increase or decrease the total tax.

Section 2001(g), added to the Internal Revenue Code as the result of the recently enacted “Tax Relief, Unemployment Insurance Authorization and Job Creation Act of 2010,” (“TRA 2010”), makes clear that, in computing the gift tax that is deemed to be previously paid, the rates of tax in effect at the date of the decedent’s death are to be used in lieu of the rates of tax in effect at the date of the gift. If the rates of tax in effect at the date of the decedent’s death are used for this purpose, there should be no additional tax due as a result of including prior taxable gifts in the computation.

Unfortunately, section 2001(g), along with the entirety of TRA 2010, is scheduled to sunset after 2012. A number of commentators have posited that, without section 2001(g), the rates of tax on the date of the gift must be used to compute the gift tax deemed to be previously paid. This theory is based primarily on the calculations required on the worksheets to Form 706, which has not been updated since 2009. Using the rates of tax in effect on the date of the gift - as required on the Form - would result in a higher overall tax if the rates increase between the date of the gift and the date of death - as may happen if TRA 2010 sunsets after 2012.

As we stated in our prior Washington Report, however, this result is far from clear, and many believe that this result would not be reached even if the sunset of section 2001(g) is taken into account.

What is reasonably clear is that Congress did not intend that gifts made during 2011 and 2012 would be subject to an additional estate tax in 2013 and thereafter. Furthermore, it is likely that some type of administrative or legislative relief will be forthcoming assuming that an unintended “glitch” does exist. This relief may be as simple as revising the Form 706.

In the meantime, as discussed in our Bulletin No. 11-09, and for the reasons stated therein, we believe that producers should be confident in working with their clients to ensure the maximum use of their exemptions during 2011 and 2012 despite the discussion around the claw back scenario.

Any AALU member who wishes to obtain a copy of the Title III of P.L. 111-312, “Tax Relief, Unemployment Insurance Authorization and Job Creation Act of 2010” may do so through the following means: (1) use hyperlink above next to “Major References,” (2) log onto the AALU website at [www.aalu.org](http://www.aalu.org) and enter the *Member Portal* with your last name and birth date and select *Current Washington Report* for linkage to source material or (3) email Anthony Raglani at [raglani@aalu.org](mailto:raglani@aalu.org) and include a reference to this *Washington Report*.

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