February 15, 2019

The Honorable David J. Kautter
Assistant Secretary for Tax Policy
Department of the Treasury
1500 Pennsylvania Avenue, NW
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Mr. William M. Paul
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Internal Revenue Service
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Ms. Holly Porter
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RE: Comments on Proposed Regulations Regarding Estate and Gift Taxes and the Difference in the Basic Exclusion Amount

Dear Messrs. Kautter and Paul and Ms. Porter:

The American Institute of CPAs (AICPA) respectfully submits comments on the proposed regulations (REG-106706-18) regarding the increased basic exclusion amount (BEA) for estate and gift taxes enacted in Pub. L. No. 115-97 (commonly referred to as the *Tax Cuts and Jobs Act* (TCJA)). The proposed regulations affect donors of gifts made after 2017 and estates of decedents dying after 2017.

We appreciate the efforts and guidance in the proposed regulations. In addition, we recommend that the Department of the Treasury ("Treasury") and the Internal Revenue Service (IRS) provide guidance clarifying that if the BEA is lower in future years (either because of the 2026 expiration of the provision in the TCJA or other Congressional action), a taxpayer is allowed a deceased spousal unused exclusion (DSUE) that is not lower than the DSUE on the filed tax return of the first spouse to die (and not a lower BEA when the second spouse dies).

Our comments were developed by the AICPA Trust, Estate, and Gift Tax Technical Resource Panels and approved by the Tax Executive Committee.

Background

In computing the amount of Federal gift tax or the amount of Federal estate tax, the gift and estate tax provisions of the Internal Revenue Code ("Code")[1] apply a unified rate schedule to the taxpayer's cumulative taxable gifts and taxable estate on death to arrive at a net tentative tax. The net tentative tax then is reduced by a credit based on the applicable exclusion amount (AEA),

[1] Unless otherwise indicated, hereinafter, all section references are to the Internal Revenue Code of 1986, as amended, or to Treasury Regulations promulgated thereunder.

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which is the sum of the BEA within the meaning of section 2010(c)(3) and, if applicable, the DSUE amount within the meaning of section 2010(c)(4). In certain cases, the AEA also includes a restored exclusion amount pursuant to Notice 2017-15, 2017-6 I.R.B. 783. Prior to January 1, 2018, for estates of decedents dying and gifts made beginning in 2011, section 2010(c)(3) provided a BEA of $5 million, indexed for inflation after 2011. The credit is applied first against the gift tax, on a cumulative basis, as taxable gifts are made. To the extent that any credit remains at death, it is applied against the estate tax.

The proposed regulations amend the Estate Tax Regulations (26 CFR part 20) under section 2010(c)(3) of the Code. The proposed regulations update § 20.2010-1 to conform to statutory changes to the determination of the BEA enacted on December 22, 2017, by sections 11002 and 11061 of the TCJA.

Section 11061 of the TCJA amended section 2010(c)(3) to provide that for decedents dying and gifts made after December 31, 2017 and before January 1, 2026, the BEA is increased by $5 million to $10 million as adjusted for inflation (increased BEA). On January 1, 2026, the BEA base will revert to $5 million. Thus, an individual or the individual's estate may utilize the increased BEA to transfer an additional $5 million without paying a transfer tax during the eight-year period beginning on January 1, 2018, and ending on December 31, 2025 (increased BEA period).

In addition, section 11002 of the TCJA amended section 1(f)(3) of the Code to base the determination of annual cost-of-living adjustments, including those for gift and estate tax purposes, on the Chained Consumer Price Index for All Urban Consumers for all taxable years beginning after December 31, 2017. Section 11002 of the TCJA also made conforming changes in sections 2010(c)(3)(B)(ii), 2032A(a)(3)(B), and 2503(b)(2)(B).

Section 11061 of the TCJA added section 2001(g)(2) to the Code, which, in addition to the necessary or appropriate regulatory authority granted in section 2010(c)(6) for purposes of section 2010(c), directs the Secretary to prescribe such regulations as may be necessary or appropriate to carry out section 2001 with respect to any difference between the BEA applicable at the time of the decedent's death and the BEA applicable with respect to any gifts made by the decedent.

Section 2010(c)(4) provides that the DSUE amount is "the lesser of (A) the basic exclusion amount, or (B) the excess of (i) the applicable exclusion amount of the last such deceased spouse of such surviving spouse, over (ii) the amount with respect to which the tentative tax is determined under section 2001(b)(1) on the estate of such deceased spouse."

Recommendation

We recommend that Treasury and IRS provide guidance clarifying that if the BEA decreases (either because of the 2026 expiration of the provision in the TCJA, or other Congressional action), the DSUE is not less than the amount of DSUE claimed on the estate tax return of the first spouse to die.

Analysis

The issue is similar to the fourth situation in the proposed regulations preamble regarding gift tax.

The third paragraph under "Explanation of Provisions" in the Preamble to the proposed regulations provides the following example:

> For example, if a decedent had made cumulative post-1976 taxable gifts of $9 million, all of which were sheltered from gift tax by a BEA of $10 million applicable on the dates of the gifts, and if the decedent died after 2025 when the BEA was $5 million, the credit to be applied in computing the estate tax is that based upon the $9 million of BEA that was used to compute gift tax payable.
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> The proposed regulations ensure that a decedent's estate is not inappropriately taxed with respect to gifts made during the increased BEA period. Congress' grant of regulatory authority in section 2001(g)(2) to address situations in which differences exist between the BEA applicable to a decedent's gifts and the BEA applicable to the decedent's estate clearly permits the Secretary to address the situation in which a gift is made during the increased BEA period and the decedent dies after the increased BEA period ends.
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> Commenters have noted that this problem is similar to that involving the application of the AEA addressed in the DSUE regulations. Section 20.2010-3(b). The DSUE amount generally is what remains of a decedent's BEA that can be used to offset the gift and/or estate tax liability of the decedent's surviving spouse. At any given time, however, a surviving spouse may use only the DSUE amount from his or her last deceased spouse—thus, only until the death of any subsequent spouse. Without those regulations, if a DSUE amount was used to shelter a surviving spouse's gifts from gift tax before the death of a subsequent spouse, and if the surviving spouse also survived the subsequent spouse, those gifts would have had the effect of absorbing the DSUE amount available to the surviving spouse at death, effectively resulting in a taking back of the DSUE amount that had been allocated to the earlier gifts. The DSUE regulations resolve this problem by providing that the DSUE amount available at the surviving spouse's death is the sum of the DSUE amount from that spouse's last deceased spouse, and any DSUE amounts from other deceased spouses that were "applied to one or more taxable gifts" of the surviving spouse.

The concern regarding the estate tax of the second spouse to die is demonstrated with the following example. If a first spouse dies during a time when the BEA is $10 million (disregarding inflation adjustments), and there is not a taxable estate (assume a full marital bequest), the amount of DSUE is the full $10 million. If the second spouse dies after the BEA reverts to $5 million (disregarding inflation adjustments), what is the amount of DSUE available to the second spouse's estate?

Without clarification, an individual could arguably interpret the language of section 2010(c)(4) to provide that the DSUE available to the second spouse's estate is not a larger $10 million, but a smaller amount of $5 million, which is the BEA then in effect. Treasury and IRS should confirm that the DSUE is $10 million.

Further, as we stated above in the background, section 2010(c)(4) provides that the DSUE claimed by the surviving spouse of a deceased spouse dying after December 31, 2010 is the *lesser of* (A) the basic exclusion amount, or (B) the excess of (i) the applicable exclusion amount of the last such deceased spouse of such surviving spouse, over (ii) the amount with respect to which the tentative tax is determined under section 2001(b)(1) on the estate of such deceased spouse. If paragraph (A) is interpreted as the BEA at the time of death of the surviving spouse, and if the BEA is less than that at the time of the predeceased spouse, the result is the loss of estate tax exemption to which the predeceased spouse was entitled at the time of death.

Therefore, the AICPA recommends that the proposed regulations clarify that the BEA described in section 2010(c)(4)(A) is the BEA at the time of the death of the predeceased spouse.

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We appreciate your consideration of these comments. If you would like to discuss these issues further, please feel free to contact Peggy Ugent, Chair, AICPA Trust, Estate, and Gift Tax Technical Resource Panel, at (512) 983-8285 or peggyugent@gsrjlaw.com; Eileen Sherr, Senior Manager – AICPA Tax Policy & Advocacy, at (202) 434-9256 or Eileen.Sherr@aicpa-cima.com; or me at (408) 924-3508 or Annette.Nellen@sjsu.edu.

Sincerely,

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Chair, AICPA Tax Executive Committee

cc: The Honorable Charles P. Rettig, Commissioner, Internal Revenue Service
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