

Recent Proposed Regulations – Anti-Abuse Clawback Exception and Updated Actuarial Tables

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Steve R. Akers

Senior Fiduciary Counsel
Bessemer Trust
300 Crescent Court
Suite 800
Dallas, TX 75201
214-981-9407
akers@bessemer.com
www.bessemer.com

Ronald D. Aucutt

Senior Fiduciary Counsel
Bessemer Trust
703-408-3996
aucutt@bessemer.com

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Introduction

The 2021-2022 IRS Priority Guidance Plan includes the following two items in the “Gifts and Estates and Trusts” section:

3. Regulations under §2010 addressing whether gifts that are includible in the gross estate should be excepted from the special rule of § 20.2010-1(c).
9. Regulations under §7520 regarding the use of actuarial tables in valuing annuities, interests for life or terms of years, and remainder or reversionary interests.

Those two projects in particular have been “front-burner” projects, and the IRS has released proposed regulations addressing both of those projects over the last several weeks.

Ron Aucutt addresses the clawback anti-abuse proposed regulation published in the Federal Register on April 27, 2022, in Item 1, and Steve Akers summarizes the updated actuarial tables proposed regulation published in the Federal Register on May 5, 2022, in Item 2.

1. Proposed Regulations Proposing Anti-Abuse Exception to Anti-Clawback Regulation

- a. **General Anti-Clawback Rule.** If a client makes a \$12 million gift in 2022 (when the gift exclusion amount is \$12.06 million) but dies in 2026 after the basic exclusion amount has sunsetted to \$5 million indexed (say \$6.8 million), the \$12 million is added into the estate tax calculation as an adjusted table gift, but the estate exclusion amount is only \$6.8 million. So will estate tax be owed on the difference? Regulation §20.2010-1(c)(1), published November 26, 2019, provides relief from “clawback” of the saved tax. The special anti-clawback rule in Reg. §20.2010-1(c)(1) allows the estate to compute its estate tax credit using the higher of the BEA (basic exclusion amount) applied to gifts made during life or the BEA applicable on the date of death. Therefore, in the example above, if the donor dies when the BEA is \$6.8 million, the \$12 million gift would be included in the estate tax calculation as an adjusted taxable gift, but the available exclusion amount would be the larger of the \$6.8 million BEA at the date of death or the \$12 million of BEA applied to gifts made during life, or \$12 million. For a detailed discussion of the estate tax calculation process and the operation of the anti-clawback special rule, see Item 5.c of Aucutt, *Washington Update: Pending and Potential Administrative and Legislative Changes (May 2022)* found here and available at www.bessemertrust.com/for-professional-partners/advisor-insights.

- b. **An Anti-Abuse Warning.**

- (1) The preamble to the 2019 anti-clawback final regulations adds:

A commenter recommended consideration of an anti-abuse provision to prevent the application of the special 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. Examples include 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. The purpose of the special rule is to ensure that bona fide inter vivos transfers are not subject to inconsistent treatment for estate tax purposes. Arguably, the possibility of inconsistent treatment does not arise with regard to transfers that are treated as part of the gross estate for estate tax purposes, rather than as adjusted taxable gifts. An anti-abuse provision could except from the application of the special rule transfers where value is included in the donor’s gross estate at death. Although the Treasury Department and the IRS agree that such a provision is within the scope of the regulatory authority granted in section 2001(g)(2), such an anti-abuse provision would benefit from prior notice and comment. Accordingly, this issue will be reserved to allow further consideration of this comment.

- (2) The commenter the preamble cites is the Tax Section of the New York State Bar Association, in its February 20, 2019, letter to Treasury and the IRS available at <https://nysba.org/NYSBA/Sections/Tax/Tax%20Section%20Reports/Tax%20Section%20Reports%202019/1410%20Report.pdf>.
- (3) For an in-depth discussion of this issue, see Lynagh, *Potential Anti-Abuse Rules May Limit Use of the Temporarily Increased Gift Tax Exclusion*, 45 Tax Mgmt. Est., Gifts & Tr. J. 183 (May 14, 2020).

(4) To illustrate the circumstances in which such an anti-abuse rule might apply, consider again the example above, a \$9 million gift in 2019 and an otherwise taxable estate of \$20 million and basic exclusion amount of \$6.8 million in 2026, except that the gift is of such nature that the value of the property is included in the donor's gross estate under, for example, section 2036, thereby making the taxable estate \$29 million (assuming no intervening change in value), **while the gift itself is excluded from "adjusted taxable gifts" (line 4 of the estate tax return) under the last phrase of section 2001(b)**. In that case, the **intuitively correct estate tax** seems to be the tax on a taxable estate of \$29 million, which is **\$8,880,000** (as shown under "Illustrating Clawback" in the above table, calculated on the tax base of \$29,000,000 on line 3 after adding adjusted taxable gifts in that case). Two ways of computing that are:

- (a) \$11,545,800 (the tax on \$29,000,000 under the section 2001(c) rate schedule) minus \$2,665,800 (the applicable credit amount, which is the tax on the applicable exclusion amount of \$6,800,000 under the section 2001(c) rate schedule) = \$8,880,000, or
- (b) 40 percent times (the taxable estate of \$29,000,000 minus the applicable exclusion amount of \$6,800,000) = $0.4 \times \$22,200,000 = \$8,880,000$.

Thus, application of the anti-clawback calculation in this case would not eliminate an \$880,000 clawback penalty, it would in effect produce an \$880,000 bonus, as the following table indicates.

Calculation of the Estate Tax with and Without the Anti-Clawback Regulations Again Using the Estate Tax Return, Form 706 (August 2019) as a Template			
Line		Without Reg. §20.2010-1(c)	Under Reg. §20.2010-1(c)*
3c	Taxable estate	29,000,000	29,000,000
4	Adjusted taxable gifts	0	0
5	Add lines 3c and 4	29,000,000	29,000,000
6	Tentative tax on the amount on line 5	11,545,800	11,545,800
7	Total gift tax paid or payable	0	0
8	Gross estate tax (subtract line 7 from line 6)	11,545,800	11,545,800
9a	Basic exclusion amount	6,800,000	* 9,000,000
9b	DSUE amount [not applicable]	0	0
9c	Restored exclusion amount [not applicable]	0	0
9d	Applicable exclusion amount (add lines 9a, 9b, and 9c)	6,800,000	9,000,000
9e	Allowable credit amount (tentative tax on line 9d)	2,665,800	3,545,800
10	Adjustment [not applicable]	0	0
11	Allowable applicable credit amount	2,665,800	3,545,800
12	Subtract line 11 from line 8	8,880,000	8,000,000
16	Net estate tax [same as line 12 in this case]	8,880,000	8,000,000
	Intuitively correct tax	8,880,000	8,880,000
	Unintended anti-clawback bonus	0	880,000

That "bonus" is undoubtedly what prompted the IRS and Treasury to consider an "anti-abuse provision."

- c. **The Proposed "Anti-Abuse" Addition.** The April 2022 proposal would do what the 2019 preamble foretold and would address the "anti-clawback bonus" the preceding table illustrates. The proposal would add a new subparagraph (3) to the anti-clawback paragraph (c) that was added in 2019. The new subparagraph (3) provides exceptions from the anti-clawback rules of paragraph (c) for "transfers includible in the gross estate, or treated as includible in the gross estate for purposes of section 2001(b)." It elaborates such transfers as "**including without limitation**" four specific types of transfers:

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- (1) "Transfers includible in the gross estate pursuant to section 2035 [gifts made within three years of death], 2036 [transfers with a retained life estate], 2037 [transfers taking effect at death], 2038 [revocable transfers], or 2042 [life insurance proceeds], regardless of whether all or any part of the transfer was deductible pursuant to section 2522 [charitable gifts] or 2523 [gifts to the donor's spouse]." This is as forecast in the 2019 preamble. It would simply preserve the "clawback," in effect, that provisions like section 2036 have been designed to achieve since at least the 1930s.
 - (2) "Transfers made by enforceable promise to the extent they remain unsatisfied as of the date of death." Such transfers were not explicitly targeted in the 2019 preamble. But, because the donor/promisor keeps the enjoyment of the property until the promise is satisfied, there certainly is a resemblance to section 2036. As the preamble observes, such transfers have been excluded from adjusted taxable gifts under Rev. Rul. 84-25, 1984-1 C.B. 191.
 - (3) "Transfers described in §25.2701-5(a)(4) or §25.2702-6(a)(1)" of the regulations. This fulfills the explicit attention of the 2019 preamble to "certain transfers within the purview of chapter 14 of subtitle B of the Code." In two helpful paragraphs, the current preamble explains why Treasury and the IRS did not consider it necessary to also amend Reg. §25.2701-5 (as the comments of the Tax Section of the New York State Bar Association had recommended) or, similarly, Reg. §25.2702-6(b).
 - (4) Transfers that would have fit one of those three categories "but for the transfer, relinquishment, or elimination of an interest, power, or property, effectuated within 18 months of the date of the decedent's death by the decedent alone, by the decedent in conjunction with any other person, or **by any other person**" (emphasis added), unless "effectuated by the termination of the durational period described in the original instrument of transfer by either the mere passage of time or the death of any person." While similar to the existing three-year rule of section 2035, this provision is conspicuously extended to affirmative actions not by the decedent but "by any other person." The exception for "the termination of the durational period described in the original instrument of transfer" may encourage more attention to the provision of such durational periods in transfer documents.

Of course, the phrase "including without limitation" leaves open the possibility that scenarios other than the four scenarios spelled out would also be excepted from the anti-clawback rules. But the description "includible in the gross estate, or treated as includible in the gross estate for purposes of section 2001(b)" ought to be quite objective and easy to apply in most cases.

This exception from the anti-clawback rules would not apply to "[t]ransfers includible in the gross estate in which the value of the taxable portion of the transfer, determined as of the date of the transfer, was 5 percent or less of the total value of the transfer." The preamble explains this limitation by comparison to similar rules applicable to reversionary interests in sections 2037(a)(2) (estate tax consequences of the retention of a reversionary interest), 2042(2) (estate tax consequences of the possession of an "incident of ownership" in a life insurance policy), and 673(a) (consequences of a reversionary interest on the determination of grantor trust treatment). That makes sense because the types of transfers targeted by the exception do resemble reversionary interests. The preamble adds that "[t]his bright-line exception ... is proposed in lieu of a facts and circumstances determination of whether a particular transfer was intended to take advantage of the increased BEA without depriving the donor of the use and enjoyment of the property."

The proposed addition to the regulations includes seven reasonably helpful, but not particularly surprising, examples, illustrating the treatment of various combinations and amounts of gifts of cash and promissory notes, gifts to GRATs and GRITs, and use of DSUE amounts. Among other things, the examples confirm the results of the examples in the 2019 regulations that in the case of a portability election the DSUE amount is applied before the surviving spouse's basic exclusion amount.

- d. **Effective Date.** The contemplated addition to the regulations would apply only prospectively – that is, only to the estates of decedents dying on or after April 27, 2022, the date the proposed addition was

published in the Federal Register. But it should also be noted that it would apply to the calculation of the future **estate tax**, even if the **gift** includible, or treated as includible, in the gross estate was made before April 27, 2022. Thus, it should be expected to first apply to the estate of someone who dies after December 31, 2025, when the “sunset” enacted in 2017 occurs, which the preamble to the proposed addition acknowledges. In that way, it would achieve the “anti-abuse” outcome described above with respect to gifts made and other lifetime actions taken since 2017 that result in estate includability, even if those lifetime actions were taken before April 27, 2022.

The Ways and Means Committee’s proposal for the Build Back Better Act (H.R. 5376) on September 15, 2021, to accelerate the “sunset” to January 1, 2022, could have meant that, unless the “anti-abuse” addition was made before the end of 2021, some persons who had made post-2017 gifts with potential for inclusion in the gross estate might die before the regulations were effective. Those persons’ estates might have benefited from the unintended anti-clawback bonus. Or the regulations might have provided for retroactive application to those estates, which is sometimes done in true “abuse” cases. Such planning after December 31, 2017, by persons who die on or after April 27, 2022, would have been caught in any event.

2. Proposed Regulations Updating Actuarial Tables Used to Value Life Estates, Remainders, Annuities, and Other Factors Dependent on Life Expectancies

The actuarial tables project, added in the 2019-2020 Priority Guidance Plan, is to update the §7520 actuarial tables based on updated mortality information, which must be done every ten years and was last done effective May 1, 2009. The tables were not updated by May 1, 2019, as was required by §7520, but proposed regulations were released on May 4, 2022, and published in the Federal Register on May 5, 2022, implementing new updated actuarial tables based on new Table 2010CM. (The tables effective beginning in 2009 were based on data from the 2000 census reflected in Table 2000CM.)

- a. **Background; Updated Lx Table.** IRS officials informally indicated that the IRS had been waiting on data from another agency. That data became available on August 7, 2020, when the National Center for Health Statistics at the Centers for Disease Control and Prevention issued the decennial life table for 2009-2011, which apparently is the underlying data for the IRS actuarial tables. The new Lx table lists the number of individuals, out of a total of 100,000, who will be alive at each of ages 0-110, based on data from the 2010 census (which obviously is already more than 10 years old). The new data reflects a somewhat remarkable increase in life expectancies compared to the existing Lx table (based on 2000 census data). For example, at age 84 the number of individuals, out of the 100,000 starting pool, expected to be surviving has increased from 37,837 to 44,809, an 18.4% increase in just 10 years. Larry Katzenstein summarizes:

The improvements in longevity at older ages is truly remarkable. For example, the probability of survival from age 60 to age 90 went from 21.088% to 26.6021% in just ten years. No wonder the Today show stopped years ago highlighting viewers who attained age 100. There were just too many of them. Larry Katzenstein, *New Actuarial Tables Are Coming*, LEIMBERG CHARITABLE PLANNING NEWSLETTER #303 (Nov. 30, 2020) (includes the new Lx table, compared to the existing Lx table).

The rather dramatic increase in life expectancy from the 2010 census data compared with the 2000 census data interestingly is contrasted with a CDC report in February 2021 that life expectancy declined about one year from 2019 to the first six months of 2020 (and declined 2.7 years for non-Hispanic Black people and 1.9 years for Hispanic individuals). National Center for Health Statistics Vital Statistics Rapid Release, Rept. No. 10 (February 2021).

- b. **Updated Tables; Proposed Regulations.** Proposed regulations were published in the Federal Register on May 5, 2022. REG-122770-18. The lengthy proposed regulations update a wide variety of regulations impacted by actuarial factors. Those included regulations dealing with valuation issues for Sections 2031, 2032, 2036, 2055, 2056 (QDOTs), 2512, and 7520. Examples throughout those regulations are updated to apply the new actuarial data from the 2010 census.

The updated actuarial valuations all flow from the revised Lx table, Life Table 2010CM, that is based on data compiled from the 2010 census. Table 2010CM is in Prop. Reg. §20.2031-7(d)(7)(ii). It is the

same Lx table that was released by the Center for Disease Control almost two years ago in August 2020.

As discussed above, the life expectancies are considerably longer than under Table 2000CM. For example, various examples throughout the proposed regulations provide the life estate factors from Table S for single life calculations. The table below lists the life estate factor from the old tables (based on Table 2000CM) and the new tables (based on Table 2010CM) for various ages and for interest at 3.2% (The §7520 rate for May 2022 is 3.0%.)

Age	Life Estate Factor (based on Table 2000CM)	Life Estate Factor (based on Table 2010CM)	Percentage Increase
31	.75086	.76267	1.57%
46	.62356	.64047	2.71%
62	.44317	.46762	5.52%
68	.36860	.39217	6.39%
75	.28029	.30097	7.38%

As evidenced by this table, the most dramatic impact of the new tables compared to the old tables is for actuarial factors based on the lives of older individuals.

The updated actuarial tables are available, at no charge, via the IRS website at <https://www.irs.gov/retirement-plans/actuarial-tables>. IRS Publications 1457 "Actuarial Valuations Version 4A" (forthcoming 2022), 1458 "Actuarial Valuations Version 4B" (forthcoming 2022), and 1459 "Actuarial Valuations Version 4C" (forthcoming 2022) will provide additional references and explanations to the actuarial tables that are published on the IRS website. These publications will be available after the applicability date of the Treasury decision adopting final regulations. Of course, actuarial tables for a fixed term of years are not dependent on mortality factors, and they have not changed.

Effective Date. It is proposed that the new actuarial tables would generally apply for annuities, interests for life or a term of years, and remainder or reversionary interests that are valued as of a date on or after the first day of the month after final regulations are published in the Federal Register. The proposed regulations are subject to a period of public comment and perhaps (if requested) a public hearing. Comments are due July 5, 2022. Thus, there is no guarantee when the final regulations will be issued, or will be effective.

Transition Rules. The proposed regulations provide transition rules. Although the new tables were supposed to be finished by May 2019, transition relief is allowed only back to January 1, 2021. Taxpayers who would have benefitted from the updated tables during the 20 months from May 2019 through December 2020 are out of luck; they must use the existing tables based on over 20-year-old census data (i.e., from the 2000 census). For gifts or estates of decedents dying on or after January 1, 2021, and before the final regulations are effective, the donor or executor may choose to value the interest (including any applicable charitable deduction) based on either Table 2000CM or Table 2010 CM. The donor or executor "must consistently use the same mortality basis with respect to each interest ... in the same property." The §7520 interest rate to be utilized is the appropriate rate for the month in which the valuation date occurs, but special rules apply for charitable transfers. For charitable transfers, §7520(a) allows using the rate for the month of or either of the two months preceding the month in which the transfer is made, and if the donor or executor elects under §7520(a) to use the §7520 rate for a month prior to January 1, 2021 (i.e., November 2020 or December 2020), the donor or executor *must* use tables based on Table 2000CM. If the §7520 interest rate is elected for a month on or after January 1, 2021, and before the applicability date of final regulations, the donor or executor *may* use tables based on either Table 2000CM or Table 2010 CM, but if the transfer occurs on or after the applicability date of final regulations, the Table 2010CM *must* be used even if a prior month's interest rate is elected under §7520(a).

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- c. **Planning Implications.** The new tables result in a larger charitable deduction for CLATs for the life of an individual, but a lower deduction for a CRAT (and more difficulty in satisfying the 10% remainder test and 5% exhaustion test for a CRAT) and a lower value for the remainder in a personal residence after a retained life estate. Annuity payments for private annuity transactions and payment amounts for self-cancelling installment notes will be smaller with the new tables than with the old tables.