TRAPS FOR THE UNWARY UNDER TRA 2010

In addition to portability, TRA 2010 brings with it changes to both the gift and estate tax calculation methods, the details of which are beyond the scope of this article. However, one anomalous feature of the new methods, known as the "clawback" issue, deserves special mention. What happens if the Applicable Exclusion Amount is *reduced* after the decedent has made gifts covered by the $5 million exemption? Under a literal reading of the Act, *this would result in estate tax being payable where the estate tax unified credit is less than the unified credit for the year of the gift.* Some commentators argue that this is an unfair "clawback" of the tax benefits that result from making lifetime gifts. Assume, for example, that the date of death Applicable Exclusion Amount is reduced from $5 million to $3.5 million; the estate tax payable would thereby be increased from $3,500,000 to $3,775,000. If, at the same time, the tax rate is increased from 35% to 45% (the 2009 rate), the estate tax payable would be increased from $3,500,000 to $5,175,000!

There is some solace in the claim that the drafters of TRA 2010 did not contemplate, much less intend, such a result. But there is as yet no official confirmation that clawback was unintended. Stay tuned!

Another trap for the unwary is the tax apportionment issue. What if the recipients of lifetime gifts are different from the residuary devisees under the decedent's will? Who is responsible for paying the increased estate tax attributable to the gifts? In the absence of a state statute apportioning the increased tax to the recipients of the gift, the tax would be payable out of the decedent's probate estate. New Jersey's apportionment statute does appear to cover this eventuality [See N.J.S. 3B:24-4(a)], but the cautious drafter should, nonetheless, ensure that the recipients sign a "net gift agreement" that obligates them to pay the increased tax. In addition, the will should provide that the gift recipients are responsible for the increased tax.