WHAT EVERY ATTORNEY AND CPA NEEDS TO KNOW TO PREPARE AND REVIEW GIFT AND ESTATE TAX RETURNS

Brian Malec
Dean, Mead, Egerton, Bloodworth, Capouano & Bozarth P.A.
Orlando, FL

Mark Scott
Kaufman Rossin
Miami, FL

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A well-drafted estate plan can easily be derailed by improperly reporting the transactions and tax effects on a gift or estate tax return. The risk of errors is compounded when the advisor creating the plan is not the same professional preparing the return. It is imperative that all estate planning professionals are well-versed in the intricacies of preparing gift and estate tax returns to ensure that the intended result of an estate plan is achieved and clients are not charged with unnecessary and costly taxes. The purpose of this outline is to identify issues where mistakes are commonly found to assist attorneys and CPAs who prepare gift and estate tax returns for clients and/or review prior returns for accuracy. A gift or estate tax return should never be an after-thought. The tax compliance of the estate plan is just as critical as the plan itself.

I. THE BASICS: GIFT, ESTATE AND GST TAX RETURN REPORTING REQUIREMENTS

  A. Gift tax returns

    1. What are gifts?

      a. Gift tax is imposed on the inter vivos transfer of assets, either directly or indirectly, by a donor to a donee in exchange for less than adequate and full consideration in money or money's worth. Donative intent is not required. § 2501(a)(1) and Treas. Reg. § 25.2511-1(g)(1).

      b. If property is transferred for less than adequate and full consideration in money or money's worth, a gift results to the extent of the excess of (1) the value of the property transferred over (2) the value of the consideration received. § 2512(b) and Treas. Reg. § 25.2512-8.

      c. **TIP**: Watch for transactions, especially when related parties are involved, where assets are sold for less than fair market value. These transactions, which are commonly referred to as "part gift, part sale" transactions, often have a gift component subject to § 2501.

d. **CAUTION**: Since donative intent is not required; a gift may occur simply based on the facts. Illustratively, where four shareholders each transferred 60 shares of stock, each lot equally valued at $4,277, to a voting trust, and the shareholders received different beneficial interests in the trust (including life and remainder interests), three shareholders were deemed to have made a gift to the fourth shareholder because of the disparity in valuing each shareholder's beneficial interest. See TAMs 7806001 and 8549005.

e. Any transaction where an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed, constitutes a gift subject to tax. Treas. Reg. § 25.2511-1(c)(1). This includes the shifting of a valuable economic right or benefit to another person that reduces the donor's potential gross estate. See *Dickman v. Commissioner,* 465 U.S. 330 (1984).

2. Under § 6019, any individual U.S. citizen or resident who makes any transfer by gift is required to file a gift tax return for the calendar year in which the gift is made, unless the transfer is excluded from gift tax under one of the following sections:

   a. Annual exclusion gifts under § 2503

      1. Under 2503(b) each donor may exclude the first $14,000 ($10,000 adjusted for post-1997 inflation) of gifts (other than future interests) made to each donee during the calendar year.

         (a) The exclusion is applied to all qualifying gifts to each donee during the year in the order in which they are made until the exclusion is exhausted.

         (b) A gift tax return must be filed by a donor if annual gifts to any donee exceed the annual exclusion.

      2. Transfers that qualify for the annual exclusion do not have to be reported if the donor gives the donee a present interest in the asset and no other gifts are required to be reported.

      3. If the donor is required to file a gift tax return, then all annual exclusion gifts should also be reported on the return.

   b. Medical and educational expenses under § 2503(e)

      1. Any "qualified transfer" shall not be treated as a transfer of property by gift.

      2. For this section, a "qualified transfer" means any amount paid on behalf of an individual:

         (a) as tuition directly to an educational organization; or

(b) as medical care directly to the care provider.

c. Charitable deduction under § 2522

1. Transfers that qualify for the gift tax charitable deduction do not have to be reported if:
   (a) the donor gives the entire interest in the asset; and
   (b) no other interest in such property is or has been transferred to a non-charitable done.
2. Charitable gifts of split interests (i.e. charitable lead and remainder transfers) must generally be reported, though there is an exception to reporting gifts of conservation easements. § 6019(3)(B).
3. **TIP:** review the client's income tax return, Form 1040, for the same calendar period to determine whether any charitable gifts were made that need to be reported.

d. Marital deduction under § 2523

1. Where a donor transfers assets to a donee who, at the time of the gift, is the donor's spouse, a deduction is allowed.
2. The donee spouse must be a U.S. citizen for the unlimited marital deduction to apply.
3. When a donor transfers property to a qualified terminable interest property trust for the benefit of a U.S. citizen spouse, the QTIP election must be made on a timely filed gift tax return.
4. When a donor transfers property to a qualified domestic trust for the benefit of a non-U.S. citizen spouse, the QDOT election must be made on a timely filed gift tax return.
5. Under Section 2523(i)(2), the annual exclusion permitted for transfers to a noncitizen spouse is $147,000 ($100,000 adjusted for post-1997 inflation).
   (a) For gifts to qualify for this exclusion, the transfer also must otherwise qualify for the marital deduction under Section 2523.
   (b) Therefore, this annual exclusion does not apply to a gift of a nondeductible terminable interest to an alien spouse because such a gift to a U.S. citizen spouse would not qualify under 2523.
   (c) A transfer in trust which the donee has a general power of appointment may qualify for this exclusion.
6. A transfer in trust which the donee only has a lifetime income interest will not qualify for this exclusion.

3. Under § 6075(b), the due date for filing the gift tax return, Form 709, is:
    a. no later than April 15th of the year following the calendar year when the gifts were made;
    b. however, if the donor died during the year the reportable gift is made, the decedent's Form 709 must be filed not later than the earlier of:
        1. the due date (with extensions) for filing the donor's estate tax return, Form 706; or
        2. the due date (April 15) or the extended due date granted for filing the donor's gift tax return.
            (a) Example: A donor makes a taxable gift in February 2015 and dies on March 10, 2015. The due date of the 2015 gift tax return is the Form 706 due date of December 10, 2015.
4. The filing due date of Form 709 can be extended by the following methods:
    a. If the taxpayer donor files, by the original due date, the Application for Automatic Extension of Time to File U.S. Individual Income Tax Return, Form 4868, then there is also an automatic six month extension to file Form 709; or
    b. If the taxpayer does not extend the due date of the Form 1040 (by filing Form 4868), then the donor will receive an automatic six month extension to file Form 709 by filing the Application for Automatic Extension of Time to File Form 709, Form 8892
5. The failure to file a gift tax return makes the taxpayer donor subject to a failure to file penalty pursuant to § 6651(a), which is based on the amount of tax due.
    a. Any tax due is payable upon the due date of Form 709, without regard to any extension of time to file. § 6151.
    b. Taxpayer who expects to owe gift and/or GST tax must use the payment voucher of Form 8892.

B. Estate tax returns

1. For U.S. citizens and residents, section 6018 provides that the executor (i.e., the personal representative if one is appointed) shall file a return in all cases where the gross estate at death exceeds (1) the basic exclusion amount in effect for the year of the decedent's death, less (2) the sum of the decedent's adjusted taxable gifts plus the amount allowed as a specific exemption. §§ 6018(a)(1) and 6018(a)(3).
    a. The term "basic exclusion amount" is defined by reference to Section 2010(c). It is important to note that any Deceased Spousal Unused Exclusion (DSUE) held by the decedent at death is <u>not</u> included in the basic exclusion amount.

b. Example: Assume a U.S. citizen decedent dies in 2015 with a gross estate of $3.5 million when the basic exclusion amount is $5,430,000. Assume further that, at the time of the decedent's death, he had $3 million of adjusted taxable gifts that were made prior to 2015. Although the decedent's estate is only $3.5 million, the executor of the decedent's estate is required to file an estate tax return because the adjusted taxable gifts are factored in for purposes of determining the estate tax filing requirement under § 6018.

c. An estate tax return is required to be filed if the threshold under § 6018 is met, *even if* no tax will be due (as a result of a marital deduction, charitable deduction or otherwise).

2. For nonresident/noncitizens, the executor shall file a return where the gross estate situated in the United States exceeds (1) $60,000, less (2) the sum of the decedent's adjusted taxable gifts plus the amount allowed as a specific exemption. §§ 6018(a)(2) and 6018(a)(3).

3. If the estate of a citizen or resident decedent is not required under § 6018 to file an estate tax return because the gross estate is less than the filing threshold, a return is nonetheless required in order to make a portability election for the deceased spouse's unused exclusion amount (see Section VII for additional information).

4. What if there is no personal representative appointed by the court?

   a. If there is no personal representative, for example because the decedent's assets passed outside the decedent's Last Will and Testament, then the person(s) in possession of the property have the duty to file the Form 706. Treas. Reg. § 20.6018-2. In a typical estate plan, this would be the trustee of a decedent's revocable trust.

   b. If the personal representative is unable to make a complete return as to any part of the decedent's gross estate, then the personal representative shall include, on the filed Form 706, a description of such missing part, including the name of every person holding a legal or beneficial interest therein. § 6018(b).

5. The estate tax return, Form 706, must be filed within nine months after the decedent's death. § 6075(a).

   a. The due date is the numerically corresponding day on the ninth calendar month after death. Treas. Regs. §§ 20.6018-1(d) and 20.6075-1.

   b. Where there is no corresponding day in the ninth month, the due date is the last day of the month. Therefore, if the date of death is May 30th, then the Form 706 due date is February 28 (or February 29 in a leap year).

c. If the due date falls on a weekend day or holiday, the due date is the next day which is not a weekend day or holiday. Treas. Reg. § 20.6075-1.

d. **TRAP**: A decedent's date of death relates back to the actual date in the decedent's domicile time zone. Rev. Rul. 66-85, 1966-1 C.B. 213. The decedent's date of death for estate tax purposes may be different from the actual date of death reflected on the death certificate.

6. The filing due date for Form 706 can be automatically extended by 6 months by filing an Application for Extension of Time to File and Return, Form 4768, by the due date of the return. Treas. Reg. § 20.6081-1(b).

   a. The IRS may, in its discretion, also grant extensions upon the showing of good and sufficient cause, such as when the personal representative is abroad or the personal representative did not timely request an automatic 6 month extension. Treas Reg. § 20.6081-1(c).

7. Filing Form 4768 does not automatically extend the due date for the full amount of estimated estate tax. Treas. Reg. § 20.6081-1(e).

   a. However, the estate can apply for an extension of time, up to a one year period, to pay the estate tax, using Form 4768, Part III. § 6161.

   b. The application must have a written statement that details why it is impossible or impractical to pay the estate and/or GST tax by the return due date.

   c. **TIP**: To protect the estate from underpayment penalties and interest, consider requesting an extension of time to pay in estates where the size of the gross estate is not completely ascertained or you have not decided which deductions will be claimed on the return.

8. **CAUTION**: Under § 6651, the late filing penalty is 5% per month of the estate tax due, not to exceed 25%. However, one day late is equal to one whole month. Therefore, if a Form 706, reflecting $1,000,000 of estate tax, is filed one day late, there is a $50,000 late filing penalty.

9. **TRAP**: A late filed return may result in the inability to make a Section 6166 election to defer payment of estate taxes attributable to closely held business assets included on the return.

C. Generation-skipping transfer tax returns

1. The requirements relating to the filing of the tax return depend on the type of generation skipping transfer involved. Treas. Reg. § 26.2662-1.

2. Form 706-GS(T) is used to report Generation Skipping Transfer Taxable Terminations.

a. Required to be filed by the trustee to report any taxable termination during the year and pay any corresponding GST tax.

b. Since there is no de minimis exception, the form must be filed even if no tax is due.

c. Under § 2612(a), a taxable termination is a termination, (by death, lapse of time, release of power, or otherwise) of an interest in property held in a trust, unless:

   1. immediately after such termination, a non-skip person has an interest in such property; or

   2. at no time after such termination may a distribution (including distributions on termination) be made from such trust to a skip person.

d. If, upon the termination of an interest in property held in trust by reason of the death of a lineal descendant of the transferor, a specified portion of the trust's assets are distributed to 1 or more skip persons (or 1 or more trusts for the exclusive benefit of such persons), such termination shall constitute a taxable termination with respect to such portion of the trust property. § 2612(a)(2).

e. Form 706-GS(T) is filed with the Internal Revenue Service in Cincinnati, Ohio.

f. The return must be filed no later than the 15th day of the fourth month after the close of the calendar year in which the transfer occurs. Treas. Reg. § 26.2662-1(d)(1).

g. **TIP:** An automatic six month extension of time to file can be requested by filing the Application for Automatic Extension of Time to File, Form 7004. However, if you want to request an extension of time to pay GST tax, a Form 4768 must be filed. See § 2661 and PLR 9314050.

3. Form 706-GS(D-1) is a Notification of Distribution from a Generation Skipping Trust.

   a. Required to be filed by the trustee when the trust makes a taxable distribution.

   b. Under § 2612(b), a taxable distribution is an income or principal distribution from a trust to a skip person (other than a taxable termination or direct skip).

   c. Since there is no de minimis exception, the form must be filed for each skip person who receives a distribution.

   d. **TRAP**: A distribution of income or corpus from a trust having a GST inclusion ratio of zero to a skip person is still a taxable distribution. Therefore, pay particular attention to the situation where a Form 706-GS(D-1) needs to be filed, even though there is subsequently no requirement for the beneficiary to file Form 706-GS(D).

4. Form 706-GS(D) is used to report a Generation Skipping Transfer Taxable Distribution.
   a. The trust beneficiary that receives Form 706-GS(D-1) must file Form 706-GS(D) to report the taxable distribution if any GST tax is actually due. Therefore, it is not necessary for a distributee to file this form if the distribution is received from a wholly GST exempt trust.
   b. These forms are to be filed with the Internal Revenue Service in Cincinnati, Ohio.
   c. The returns must be filed no later than the 15th day of the fourth month after the close of the calendar year in which the transfer occurs. Treas. Reg. § 26.2662-1(d)(1).
   d. **TIP:** An automatic six month extension can be requested by filing the Application for Automatic Extension of Time to File, Form 7004. However, if you want to request an extension of time to pay GST tax, a Form 4768 must be filed. See § 2661 and PLR 9314050.

II. THE IMPORTANCE OF SATISFYING ADEQUATE DISCLOSURE

A. General rules

1. The IRS generally has 3 years after a gift or estate tax return is filed to assess tax or begin a court proceeding for the collection of tax, except as to an item which is not "disclosed in the return or in a statement attached to the return in a manner adequate to apprise the Secretary of the nature of such item". § 6501(a) and (c)(9).
2. The 3 year limitations period is increased to 6 years after a gift or estate tax return is filed if the taxpayer omits from the gross estate or total gifts items that exceed 25% of the gross estate or total gifts stated in the return. § 6501(e)(2).
3. If a gift is not adequately disclosed, then gift tax may be assessed, or a proceeding in court for collection of the appropriate tax may be begun without assessment, at any time. Treas. Reg. § 301.6501(c)-1(f)(1).
4. If a transfer is adequately disclosed and the limitations period expires, then the IRS is precluded from later redetermining the amount of the gift for purposes of assessing gift tax or for determining the estate tax liability. § 2001(f).

B. Adequate disclosure of gifts

1. Treas. Reg. § 301.6501(c)-1(f)(2) provides that transfers reported on a return as gifts will be considered adequately disclosed if the return or a statement attached to the return provides the following information:

a. A description of the transferred property and any consideration received by the transferor;
b. The identity of, and relationship between, the transferor and each transferee;
c. If the transfer was made in trust, then the trust's taxpayer identification number and either a copy of the trust or a brief description of the trust terms;
d. Either:
    1. A detailed appraisal from a qualified independent appraiser that satisfies the requirements of Treas. Reg. § 301.6501(c)-1(f)(3); or
    2. A detailed description of the method used to determine the fair market value of the property transferred, including any financial data or restrictions utilized in determining the value and a description of any discounts claimed; and
e. A statement describing any position taken that is contrary to any proposed, temporary or final Treasury regulations or revenue rulings published at the time of the transfer.

2. See Exhibit 1 for sample disclosure statement for purposes of Treas. Reg. § 301.6501(c)-1(f)(2).

C. Adequate disclosure of non-gifts (i.e., sales to grantor trusts or related parties, etc.)

1. Treas. Reg. § 301.6501-1(f)(4) provides two options to meet the adequate disclosure requirements for non-gift completed transfers.
    a. Completed transfers to family members that are made in the ordinary course of business are deemed to be adequately disclosed for gift tax purposes, even if not reported on a gift tax return, if the transfer is properly reported by all parties for income tax purposes.
        1. Example – salary paid to a family member of a family company would be adequately disclosed if the payment is reported consistently by the business and the family member on their income tax returns.
        2. Although not specifically addressed under the regulation, query whether you can meet this test for a sale to a grantor trust by merely reporting the new ownership on the next income tax return for the company. Since the sale is disregarded for income tax purposes, the details of the sale would not show on the transferor's income tax return, except the ownership would be updated.
    b. Any other non-gift completed transfer will be considered adequately disclosed only if the following information is provided on, or attached to, the return:

1. A description of the transferred property and any consideration received by the transferor;
2. The identity of, and relationship between, the transferor and each transferee;
3. If the transfer was made in trust, then the trust's taxpayer identification number and either a copy of the trust or a brief description of the trust terms;
4. A statement describing any position taken that is contrary to any proposed, temporary or final Treasury regulations or revenue rulings published at the time of the transfer; and
5. An explanation as to why the transfer is not a gift for gift tax purposes.

c. Note that the reporting requirements for non-gift completed transfers do not expressly require a detailed appraisal or description of the method used to determine the fair market value, as required for the reporting of gift transfers under Treas. Reg. § 301.6501(c)-1(f)(2). However, adequately explaining why a transfer is not a gift most likely will include a representation that consideration equal to fair market value was paid. Therefore, return preparers would be well-served to substantiate fair market value consistent with the requirements of Treas. Reg. § 301.6501(c)-1(f)(2).

2. See Exhibit 2 for sample disclosure statement for purposes of Treas. Reg. § 301.6501(c)-1(f)(4).

3. Should non-gift completed transfers be disclosed? Here are some considerations:

a. Taxpayers are not required to disclose non-gift transfers unless they want to start the statute of limitations for the IRS to assert a gift was made and assess gift tax.

b. If a transaction is <u>not</u> disclosed:

1. IRS has an unlimited period of time to assess gift tax on the transaction, which opens the door to the possibility of a substantial amount of interest and penalties if it is later determined a gift was made.
2. Taxpayer will not have any certainty that future gifts will not create gift or GST tax because it is unclear if exemption was used up in the "non-gift" transaction. This uncertainty may also cause the taxpayer to be reluctant about future planning because it is possible the subsequent planning will cause tax rather than merely use exemption.

3. IRS challenge could come many years later when critical information and the professionals involved in the transaction are not readily available.

c. If a transaction is adequately disclosed:

1. IRS has three years to assess tax.
2. Taxpayer's remaining exemptions are clear after the expiration of the limitations period.
3. Information necessary to defend against an IRS challenge, and the professionals involved in the transaction, should be readily available.
4. There is no indication that disclosure of non-gift transfers increases the audit risk.

D. Split-gifts

1. For split-gift returns, adequate disclosure will be satisfied with respect to the gift deemed to be made by the consenting spouse if the return filed by the donor spouse satisfies the disclosure requirements with respect to that gift. Treas. Reg. § 301.6501-1(f)(6).

E. Formula Gifts

1. Form 709 should disclose the formula defining the amount transferred rather than a specific percentage or number of units believed to be transferred pursuant to the formula.
2. The IRS has argued in prior cases that reporting a specific percentage interest on the Form 709 is determinative for gift tax purposes rather than the formula defining the transfer.

a. *Knight v. Commissioner*, 115 T.C. 506 (2000).

1. Taxpayer transferred partnership interests with a value of $300,000 to donees, but their gift tax returns reported a gift to each donee of a 22.3% partnership interest without reporting a value for each interest. The IRS argued that the value of the 22.3% interest was greater than $300,000. At trial, the taxpayers argued their gifts were actually less than $300,000.
2. The Tax Court found that specifically reporting the gift of a 22.3% interest on the gift tax returns, coupled with the taxpayers arguing for a value less than $300,000, showed the taxpayers' disregard for the transfer documents defining a specific value for the gift, as opposed to a specific percentage interest, and the taxpayers' intent to gift 22.3% interests rather than $300,000 worth of partnership interests.

b. *Wandry v. Commissioner*, T.C. Memo 2012-88.

1. Taxpayers made defined value gifts to several donees of the number of units in Norseman Capital LLC so that the fair market value of such units for federal gift tax purposes shall be $261,000. The taxpayers' gift tax returns listed the appropriate value intended to be transferred, but also described the gifts as transfers of a 2.39% membership interest.
2. The IRS, relying in part on *Knight v. Commissioner*, argued that the inclusion on the gift tax return of the specific percentage interest thought to be transferred was an admission by the taxpayers that such percentage interest was intended to be transferred rather than a defined dollar value, and, therefore, the taxpayers should be bound by the gift tax return.
3. Fortunately for the taxpayers, the Tax Court distinguished *Knight* and held that the reporting, in total, of the gifts and their values was consistent with the transaction documents under which the formula gift was made. Therefore, the taxpayer prevailed.

3. **TIP:** To satisfy the adequate disclosure requirements and avoid opening the door to the arguments from the IRS found in *Knight* and *Wandry*, a taxpayer should report the formula defining the transfer on the gift tax return, rather than the specific percentage or units believed to be transferred, and attach the transfer document(s) (e.g., assignment or stock power) containing the formula provision. Given the complexity of properly drafted formulas, a taxpayer who does not attach the actual transfer documents runs the risk of inadequately describing the gift in the limited space provided on the gift tax return.

F. Effective date

1. The adequate disclosure regulations apply to gifts made after December 31, 1996 for which the gift tax return for such calendar year is filed after December 3, 1999.

G. Disclosure of prior gifts not reported on a gift tax return

1. Rev. Proc. 2000-34

a. Applies where the donor filed a gift tax return for the appropriate calendar year but failed to adequately disclose a gift because either the gift was not reported on the return or because the information required under Treas. Reg. § 301.6501(c)-1(f)(2) was not submitted with the return.

b. Appropriate procedure is to file an amended gift tax return for the calendar year in which the gift was made with the same IRS Center where the donor filed the original gift tax return. The amended return must include the information required under Treas. Reg. § 301.6501(c)-1(f)(2) and contain at the top of the first page "Amended Form 709 for gifts made in [insert calendar year] – In accordance with Rev. Proc. 2000-34, 2000-34 I.R.B. 186."

c. If the requirements of Rev. Proc. 2000-34 are satisfied, then the period of limitations will commence as of the date the return is filed.

2. If a gift tax return was not filed for the year of the transfer at issue, then under a strict reading, Rev. Proc. 2000-34 does not address this situation. However, the taxpayer should be able to file a late return to adequately disclose the transfer and start the limitations period.

III. FILING AMENDED OR SUPPLEMENTAL FORMS 706 AND 709

A. Code, Treasury Regulations, and Instructions

1. Estate tax return, Form 706

a. After filing Form 706, it is unclear whether the executor has a duty to file a supplemental return to amend positions originally reflected.

b. Under the regulations, the taxpayer has a duty to file a return as complete as possible before the expiration of the extension period obtained for filing. The Form 706 cannot be amended after the expiration of the extension period that was obtained for filing the return. However, supplemental information may later be filed that may result in a different finally determined tax than the amount shown on the return. Treas. Reg. § 20.6081-1(d).

c. In addition, the Form 706 Instructions indicate that to change something on an estate tax return, the executor should file another Form 706 and write "Supplemental Information" across the top of the first page.

2. Gift tax return, Form 709

a. After filing Form 709, it is unclear whether the taxpayer/donor has a duty to file an amended return.

b. There seems to be no statutory, regulatory, nor instructional provisions relating to the amending of gift tax returns or providing supplemental information to a previously filed Form 709.

3. Tax returns in general

a. An early General Counsel Memorandum stated that there is no statutory authority for filing or accepting amended returns. G.C.M. 35738 (March 21, 1974).

b. Though the Code and Regulations may provide when a taxpayer is permitted to file an amended return, there is no requirement to file such a return. Treas. Reg. § 1.451-1(a).

c. If a taxpayer ascertains that an item should have been included in gross income, the taxpayer ***should***, if within the statute of limitation period, file an amended return. Treas. Reg. § 1.451-1(a).

d. If a taxpayer improperly claimed a deduction, the taxpayer ***should*** if within the statute of limitations period, file and amended return. Treas. Reg. § 1.461-1(a)(3)(i).

e. The usage of "***should***" as opposed to "***must***" or "***shall***," seems to indicate that, though not mandatory, it is advisable to file an amended return.

B. U.S. Supreme Court case: *Badaracco v. Commissioner*

1. The U.S. Supreme Court held that the filing of an amended return does not start the running of the statute of limitations if the original return was fraudulent. *Badaracco v. Commissioner*, 464 U.S. 386 (1984).

2. The Court noted that although several regulations refer to an amended return, none of them require the filing or acceptance of such amended return. *Badaracco v. Commissioner*, 464 U.S. at 393.

C. Ethical considerations: Circular 230

1. Though there is no absolute duty to file supplemental information or an amended return, what happens in a situation where the attorney or certified public accountant discovers the return error?

2. Treasury Department Circular No. 230 governs the practice of attorneys, CPA's, and others before the IRS.

3. A practitioner who, having been retained by a client with respect to a matter administered by the Internal Revenue Service, knows that the client has not complied with the revenue laws of the United States or has made an error in or omission from any return, document, affidavit, or other paper which the client submitted or executed under the revenue laws of the United States, must advise the client promptly of the fact of such noncompliance, error, or omission. Circular 230 § 10.21.

4. The practitioner must advise the client of the consequences as provided under the Code and regulations of such noncompliance, error, or omission. Circular 230 § 10.21.

5. However, § 10.21 of Circular 230 does not require the practitioner to advise the client to amend the originally filed return.

6. In addition, there is no requirement that the professional withdraw from further representing the client who fails to file an amended return. Consider, however, the ethical dilemma that the practitioner may find himself or herself in the client does not correct the error.

a. Section 10.22 of Circular 230 advises that the practitioner must exercise due diligence in preparing or assisting in the preparation of tax returns; including the determination of the correctness of oral and written representations made by the practitioner to their clients and the IRS. Circular 230 §§ 10.22(a)(1)-(3).

b. Section 10.51(4) of Circular 230 provides that a practitioner may be sanctioned for giving false or misleading information, or participating in any way in the giving of false or misleading information to the Department of Treasury.

c. Thus, where previously reported errors have an effect on future returns, Circular 230 may restrict a practitioner's signing of a subsequent return that incorporates the previous error and the future representation about the error before the IRS.

IV. ANNUAL EXCLUSION ISSUES

A. Under § 2503(b) each donor may exclude the first $14,000 ($10,000 adjusted for post-1997 inflation) of gifts (other than future interests) made to each donee during the calendar year.

1. The exclusion is applied to all qualifying gifts to each donee during the year in the order in which they are made until the exclusion is exhausted.

2. A gift tax return must be filed by a donor if annual gifts to any donee exceed the annual exclusion.

B. Transfers that qualify for the annual exclusion do not have to be reported if:

1. The donor gives the donee a present interest in the asset; and

2. No other gifts are required to be reported.

Note: if donor has to report any gift, then all annual exclusion gifts should also be reported on the return.

C. Crummey Withdrawal Rights

1. Donors who prefer to use a trust to benefit the donee, and thus not to have an outright ownership over the property until a future time, need to include specific withdrawal rights in the trust instrument for contributions to qualify as a "present interest" and, therefore, for the annual exclusion.

a. In *Crummey v. Commissioner*, 397 F.2d 82 (9th Cir. 1968), the court held that the beneficiary must have an unrestricted right to withdraw all, or a portion of, the annual additions to corpus.

b. If the beneficiary can immediately enjoy the property by exercise of the demand right, the beneficiary has a present interest.

c. The trust instrument may also permit the donor to exclude a person from having the withdrawal right, without invoking §§ 2036 or 2038. PLR 9030005.

d. Even if the demand right is not in the original trust document, it may be granted by the instrument that accomplished the subsequent gift to the trust. PLR 8134135.

e. If a demand right is conveyed to more than one beneficiary, the donor is entitled to an annual exclusion for each donee.

f. In *Estate of Cristofani v. Commissioner*, 97 T.C. 74 (1991), the Tax Court rejected the IRS' position that remote contingent remainder beneficiaries' power of invasion is illusory and the annual exclusion will not apply unless the right is actually exercised.

2. A Crummey power withdrawal right is a general power of appointment held by the trust beneficiary that lapses upon the termination of the withdrawal period.

   a. The lapse of a power of appointment during the life of the individual beneficiary is treated as a transfer of the property by the individual possessing such power. § 2514(e).

   b. However, the lapse of the power of appointment does not reach the full extent of the withdrawal right as long as the lapse does not exceed the greater of $5,000 or five percent (5%) of the aggregate value of the assets out of which the exercise of the power could be satisfied.

   c. The effect of § 2514(e) on a lapsed Crummey power is as follows:

      1. Upon the lapse of the Crummey power withdrawal right, the donee is deemed to transfer property to the trust equal to the value of the property that could have been withdrawn, less the greater of the $5,000 or 5% amount;

      2. That lapse, or deemed transfer, can subject the donee to a gift tax and cause inclusion of the trust assets in his estate for estate tax purposes.

   d. An option to limit the donee's withdrawal right to the greater of $5,000 or 5% amount will eliminate the deemed transfer to the trust.

   e. **TIP:** Return preparers should verify whether the governing instrument limits the withdrawal right.

      1. Sometimes a single trust agreement is executed for the benefit of many people; with each person's beneficial share "held in a separate trust".

      2. Note that the 5% amount is determined by multiplying 5% times the value of the principal in the beneficiary's separate trust.

      3. A common mistake is to use the value of the entire trust to calculate the 5% amount.

D. Election for § 529 Plans

1. Contributions to a qualified state tuition plan under § 529, in excess of the annual exclusion may be treated as being ratably made over a five (5) year period, with the year of the contribution being the first year. To make the election, the taxpayer donor checks the appropriate box on Form 709.

2. It is not necessary to report the gifts deemed to be made in the 4 years following the initial year unless a return is required to be filed to report other gifts.

3. **TIP:** It is important to keep track of gifts deemed to be made in years 2-5 as a result of the 5 year election. A common mistake is for a donor to make an additional gift in years 2-5, forgetting that annual exclusion gifts have already been used up for the donee in those years. As a result, a gift made in year 2-5 might either use exemption or be subject to gift or GST tax. Moreover, a return preparer needs to review returns for the prior 4 years to see if the 5 year election was made. One should not assume that a 5 year election was not made just because returns have not been filed in recent years.

E. Section 2642(c) GST Exclusion

1. Section 2642 provides that a direct skip (i.e., a transfer to a skip person) which is either a § 2503(b) annual exclusion gift or § 2503(e) educational or medical expense exclusion gift will be deemed to have an inclusion ratio of zero. As a result, no exemption is required to be allocated to avoid GST tax and no GST tax will be due.

2. Transfers in trust, however, will not qualify unless:

   a. No portion of the trust income or principal may be distributed during the beneficiary's life to or for the benefit of a person other than the specific beneficiary, and

   b. The assets of the trust will be included in the specific beneficiary's gross estate if the trust does not terminate before the beneficiary dies.

3. **CAUTION:** To qualify for § 2642(c) for a transfer in trust, the trust must only have one beneficiary, who must be a skip person, and the trust must be included in that skip person's gross estate. Therefore, gifts to a pot trust for multiple skip people or descendants, or to a trust which only grants the skip person a testamentary limited power of appointment, will not qualify.

4. **CAUTION:** In order for a transfer to a grandchild to qualify for the § 2642(c) exclusion, the transfer must first qualify as an annual exclusion gift under § 2503(b). Therefore, the ordering of gifts in a calendar year to a grandchild is very important. For example, assume a crummey gift is made in February to a trust which has children and grandchildren as crummey beneficiaries. The crummey gift allocable to the grandchild, although it qualifies for the annual exclusion, does not qualify for the exclusion under § 2642(c)(2). Therefore, GST exemption must be allocated to the crummey gift allocable to the grandchild if the trust is intended to be GST exempt. Further, assume a gift is made outright to the same grandchild later on in August which is intended to take advantage of

the § 2642(c) exclusion. The August gift will <u>not</u>, however, qualify for the § 2642(c) exclusion because the annual exclusion gift for that grandchild was used up when the February gift was made to the trust. As a result, the August transfer will either incur GST tax or use exemption. If the outright transfer instead had been made prior to the February gift to the trust, then the taxpayer could have taken advantage of § 2642(c) and saved GST exemption or GST tax.

V. SPOUSAL GIFT-SPLITTING ISSUES

A. General rules

1. Both spouses must signify consent. Treas. Reg. § 25.2513-2.

a. Method

1. If both spouses file gift tax returns, it is sufficient if:

i. The consent of each spouse is signified on each other's return;

ii. The consent of each spouse is signified on their own returns; or

iii. The consent of both spouses is signified on one of the returns.

2. If only one spouse files a return, consent must be signified on that return.

3. Executor of a deceased spouse, or guardian of incompetent spouse, can make the election.

b. Timing

1. Consent must be signified on the <u>first</u> return filed by either spouse. Therefore, if one spouse files a return, but fails to make the election, then gifts cannot be split for that year.

2. The split-gift election cannot be made on an amended return. Likewise, the split-gift election cannot be made on the return for the second spouse if the first spouse previously filed a return which did not include a split-gift election.

i. Caveat: if one spouse files multiple returns prior to the due date, the last return filed is considered as the return for purposes of determining whether the election has been made. Treas. Reg. § 25.2513-2(a)(1).

3. If neither spouse filed a timely gift tax return, then the split-gift election <u>can</u> be made on a late filed return as long as it is the first return filed.

4. Election cannot be made after a notice of deficiency has been sent to either spouse.

2. All gifts in a calendar year, other than gifts prohibited from being split under Treas Reg. § 25.2513-1(b), must be split. A spouse cannot pick and choose which gifts to split.
3. Spouses must be married at the time of the gift and cannot remarry prior to the end of the calendar year.
4. Both spouses must be a citizen or resident of the United States.
5. It is not always necessary for both spouses to file a return. Treas. Reg. §§ 25.6019-1 and 25.6019-2.
    a. Both spouses are required to file a return if each spouse separately makes gifts in excess of annual exclusions.
    b. Both spouses are required to file a return if each spouse is deemed to make gifts in excess of annual exclusions as a result of splitting gifts.
    c. If one spouse is required to file a return because he or she made gifts in excess of the annual exclusion, the other spouse is <u>not</u> required to file a return if, as a result of splitting gifts, the transfers deemed to be made by the other spouse do not exceed annual exclusions.

B. Limitations on Splitting Gifts (Treas. Reg. § 25.2513-1(b)).
1. If the spouses were not married during the entire year, then the gifts made during the period they were not married cannot be split.
2. Consent is not effective with respect to any gift made during the period that one spouse was a nonresident, noncitizen of the U.S.
3. Consent is not effective with respect to a gift by one spouse where the other spouse has a general power of appointment over the gifted property.
4. Transfers to consenting spouses and third parties
    a. If one spouse transfers property in part to a spouse and in part to third parties (e.g. transfer to a trust for the benefit of spouse and descendants), the consent is effective with respect to the interest transferred to third parties only insofar as the interest transferred to the third parties is severable from the interest transferred to the spouse.
    b. The regulations refer to the principles for valuing annuities, life estates, terms for years, remainders and reversions to determine the portion of a gift that is severable.
    c. One common situation is where one spouse has set up a discretionary lifetime credit/family trust or SLAT for the benefit of the other spouse and descendants.
        1. Is the spouse's interest or third party's interest severable if distributions are subject to the discretion of the trustee? Unfortunately, there is not extensive authority on this issue.

i. *Robertson v. Commissioner*, 26 T.C. 246 (1956) – Taxpayer gifted stock to a trust that provided for the trustees to pay over the net income to the spouse and so much of the principal as the trustee "in its sole discretion, but with due regard to [the spouse's] other sources of funds, shall deem necessary for [the spouse's] maintenance and support . . .". Third parties were beneficiaries of the trust remainder upon the spouse's death. The Tax Court analyzed the likelihood that distributions of principal would be made to the spouse pursuant to the authority granted to the trustees. The Tax Court concluded that, although distributions were possible, there was no likelihood that distributions would be made for the spouse's maintenance and support because she had sufficient assets to meet her needs outside the trust. Therefore, the Tax Court permitted the spouse to split gifts as to principal.

ii. *Falk v. Commissioner*, T.C. Memo 1965-22 – Taxpayer transferred assets in trust for the benefit of his wife and seven children. The trust authorized distributions of income to Wife as the trustees from time to time deemed appropriate under all facts and circumstances and also authorized distributions of principal as the trustees from time to time deemed appropriate "to provide for the proper care, comfort, support, maintenance and general welfare of the Grantor's wife and issue, and for the proper education of the Grantor's issue." The trust also included a statement of intent that the taxpayer's primary purpose was to provide for his wife's adequate care, comfort, support and maintenance, taking into consideration her other resources. Moreover, the trust generally provided that the trustees may consider factors such as other funds available to a beneficiary, and the age and health of a beneficiary, in determining whether to make distributions. The Tax Court found that the trust terms created an ascertainable standard and, after analyzing wife's financial circumstances, expenses, life expectancy and stability of her marriage, the possibility of distributions to wife during the taxpayer's life was so remote as to be negligible. However, after the taxpayer's death, the possibility of distributions were not so remote as to be negligible. Accordingly, the Tax Court did not allow the value of the spouse's life interest after the taxpayer's death to be split, but the balance of the gifts would be eligible to be split.

iii. *Wang v. Commissioner*, T.C. Memo 1972-143 – Taxpayer set up a trust which provided all income to be paid to wife during the taxpayer's lifetime and, upon the taxpayer's death, the trust would be split into Fund A and Fund B. Fund A was a general power of appointment marital deduction trust. Fund B provided that wife had an income interest and that the trustees could make distributions of principal "as the Trustees . . . in their sole and absolute discretion may deem necessary or advisable for her proper support, care and health, or any emergency affecting Donor's said wife or her family, first having regard to her other sources of income and other assets as certified to such Trustees by her." Upon wife's death, the balance was split into equal shares for descendants per stirpes. The Tax Court held that the wife's interest was not ascertainable, and thus, not severable, because the term "emergency" was unlimited and broad enough to cover any emergency which might affect wife's family. Accordingly, the Tax Court held that no portion of the gift could be split.

iv. Some PLRs have addressed gift splitting when the spouse is a beneficiary of the donee trust. See PLR 200345038, 200422051, 200551009, 200616022, 201108010, 201523003.

v. Conclusion: If the trustee's authority to make distributions to the spouse is limited by an ascertainable standard or requirement that the trustee consider the spouse's other resources, and the probability of distributions to the spouse pursuant to that standard are so remote as to be negligible, either because the spouse has sufficient other assets or some other facts, then gifts to the trust should be eligible for splitting. Conversely, if the trustee's authority to make distributions to the spouse is unrestricted, or there is more than a remote possibility, based on the facts, that distributions may be made to the spouse, then the IRS likely will assert that the spouse's interest is not severable and the portion of the gift subject to this authority cannot be split.

2. What about Crummey gifts made to a trust in which the spouse's interest is not severable? Can a split-gift election be made to utilize the spouse's annual exclusions?

    i. There is very little guidance, but many practitioners believe that a spouse can elect to split crummey gifts allocated to a third party, such as a descendant, even though the spouse's interest in the trust in general may not be severable. The rationale is that the crummey gifts should be treated as gifts to the powerholders rather than gifts to the trust. Any gift in excess of the crummey gifts, however, could not be split.

    ii. Example: Assume Husband makes a $100,000 gift to a family trust for the benefit of spouse and 3 children, each of whom had crummey withdrawal rights. If the spouse consented to split the gift, then $42,000 would be treated as being made by the consenting spouse ($14,000 x 3 children) and $58,000 would be treated as being made by the Husband or gift tax purposes..

    iii. In PLR 200616022, a husband established an irrevocable trust for the primary benefit of his and his wife's children and their descendants. The trust provided the children and their descendants with a Crummey right of withdrawal. The trust also contained a QTIP marital trust in the event the husband died within three years from the date of funding and a substantial portion of the trust estate was included in the husband's gross estate. The IRS concluded that the wife had a contingent interest in the trust and that such contingent interest was susceptible of determination. To the extent the value of the transfers to the trust exceeded the actuarial value of the wife's interest as determined under § 7520, split-gift treatment was available. However, the ruling did not state whether any of the transfers to the trust exceeded the amounts that could qualify for the annual exclusion.

5. **TRAP**: For GST purposes, the consenting spouse is treated as the transferor of 50% of the gifted property *even if the consenting spouse is deemed to transfer less than 50% for gift tax purposes under § 2513.* Treas. Regs. §§ 26.2652-1(a)(4) and 26.2652-1(a)(5) ex. 9.

VI. GENERATION-SKIPPING TRANSFER TAX ISSUES

A. Confirm and Update Amount of Prior GST Exemption Used

1. **TIP:** Review prior gift tax returns for errors that affect the amount of a taxpayer's remaining gift or GST exemption! Due to the complexity of the GST allocation rules, including automatic allocations, the amount of remaining GST exemption reported on a return is a common area for mistakes, especially where the donor has historically had multiple professionals prepare gift tax returns. Although a practitioner may be able to reasonably rely on the amount of remaining exemption reported on the most recent return, it is prudent to review prior returns.
2. Failing to confirm the amount of prior GST exemption used by a taxpayer <u>prior to</u> the taxpayer making a gift could cause a 40% GST tax.
3. See Exhibit 3 for a sample statement to correct the amount of prior GST exemption used.

B. Automatic Allocation of Exemption to Gifts that are Indirect Skips

1. Section 2632(c) provides that, for lifetime transfers made after December 31, 2000, any unused portion of an individual's GST exemption shall be allocated to an indirect skip transfer in an amount necessary to make the inclusion ratio for such transfer zero.
    a. An "indirect skip" is generally defined as any gift made to a "GST Trust".
    b. A "GST Trust" is defined as a trust that <u>could</u> have a generation-skipping transfer with respect to the transferor, unless the trust meets one of the following six exceptions listed in § 2632(c)(3)(B):
        1. The trust provides that more than 25% must be distributed or may be withdrawn by a non-skip person:
            a. before such person reaches age 46;
            b. on or before a date specified in the trust that will occur before such person reaches age 46, or
            c. upon the occurrence of an event that, in accordance with the treasury regulations, may reasonably be expected to occur before such person reaches age 46;
        2. The trust provides that more than 25% must be distributed or may be withdrawn by a non-skip person who is living on the date of death of another person identified in the trust (by name or by class) who is more than 10 years older than such non-skip person;
        3. The trust provides that if a non-skip person dies on or before a date or event described above, more than 25% of the trust either must be distributed to the estate of such non-

skip person *or* is subject to a general power of appointment exercisable by such non-skip person;

4. Any portion of the trust would be included in the gross estate of a non-skip person (other than the transferor) if such non-skip person died immediately after the transfer;
5. The trust is a charitable lead annuity trust (CLAT), charitable remainder annuity trust (CRAT) or charitable remainder unitrust (CRUT); or
6. The trust is a charitable lead unitrust (CLUT).

2. The automatic allocation to an indirect skip applies regardless of whether a gift tax return is filed. To avoid the automatic allocation, the donor must elect out of automatic allocation pursuant to § 2632(c)(5).
3. Three elections are available under § 2632(c):
   a. Taxpayer can elect out of the automatic allocation of GST exemption for a particular indirect skip (see sample statement attached as Exhibit 4);
   b. Taxpayer can elect out of the automatic allocation of GST exemption for all future transfers made to a particular trust (see sample statement attached as Exhibit 5); or
   c. Taxpayer can elect to treat any trust, regardless of its terms, as a GST trust so that GST exemption will be automatically allocated to current and/or future contributions to the trust (see sample statement attached as Exhibit 6).
4. Section 2632(c) election must be made on a timely filed return by attaching a statement to the return and marking the appropriate box on Part 3 of Schedule A of Form 709 (currently, column 'c' of Part 3).
   a. For split-gift returns, each spouse must make the election. Treas. Reg. § 26.2632-1(b)(2)(iii)(A).
   b. A taxpayer can terminate an election made in a prior year with respect to future transfers by attaching a statement to a current Form 709. Treas. Regs. §§ 26.2632-1(b)(2)(iii)(E) and 26.2632-1(b)(3)(iv).
5. **CAUTION:** Part 3 of Schedule A of Form 709 is entitled "Indirect Skips". However, the instructions for Form 709 indicate that Part 3 is intended to include any transfer to a trust which could possibly have a generation-skipping transfer in the future, not just those that meet the definition of an "indirect skip" in § 2632(c)(3). In other words, Part 3 is broader in scope than § 2632(c)(3). Therefore, if a return preparer believes that a trust meets one of the exceptions to be a GST Trust under § 2632(c)(3)(B), the transfer should still be reported on Part 3 (not Part 1) of the Form 709, and an election should be made to opt out of automatic

allocation, if there is any potential for the trust to have a generation-skipping transfer at any point in the future.

6. **TIP:** The rules governing when a trust qualifies as a GST Trust and, therefore, receives an automatic allocation of GST exemption are complicated. Therefore, when the taxpayer wants a transfer to receive an automatic allocation of GST exemption, and it is not crystal clear that the Trust qualifies as a GST Trust, the taxpayer should make an election under 2632(c)(5) to treat the trust as a GST Trust. Likewise, if a taxpayer does not want the automatic allocation rules to apply, an affirmative election out of the automatic allocation rules should be made.
7. **TRAP:** Automatic allocations are one of the most prevalent areas for mistakes. One common mistake involves reporting a transfer to a trust that is exclusively for the benefit of the Settlor's child during his or her lifetime, and then pays outright to the child at some age after 46. At first glance, a return preparer might expect that no GST exemption would be allocated to this transfer since the child will receive the property outright if the child lives to the stated age. Therefore, the prior return preparer(s) may have incorrectly reported a transfer to this type of trust on Part 1 (Transfers Subject Only to Gift Tax) of the Form 709, or reported the transfer on Part 3 without making a § 2632(c) election or reporting the use of GST exemption. Unless the taxpayer elected out, § 2632(c) would have applied to automatically allocate GST exemption to transfers to this trust if a skip person would receive the property (or the child has a testamentary non-general power of appointment among descendants) upon the child's death prior to the stated payout age.

C. Late Allocations of GST Exemption During Life

1. Generally, an allocation of GST exemption on a timely filed return is effective as of the date the transfer was initially made to the trust. For example, an allocation of GST exemption to a gift made on January 1, 2015 will be deemed to be made as of January 1, 2015 even though the gift tax return reporting the allocation is not filed until April 15, 2016.
2. A taxpayer, however, can make an allocation of GST exemption to a trust *after* the due date for timely reporting a transfer to the trust, which is referred to as a "late allocation".
3. The effective date of a late allocation is the date of filing the gift tax return reporting the late allocation, except that the taxpayer can make an election to value the assets of the trust for allocation purposes as of the 1^{st} day of the month in which the return is filed. This election to value assets as of the first day of the month cannot be made, however, for a life insurance trust where the insured died during the month of filing. § 2642(b)(3); Treas. Reg. § 26.2642-2(a)(2).
4. See Exhibit 7 for a sample late allocation of GST exemption statement.

5. **CAUTION:** An allocation of GST exemption on a gift tax return that is deemed to be filed even one day late will be treated as a "late allocation", which means the effective date of allocation is the filing date rather than the date of the initial contribution to the transfer made in the prior year.
6. **TIP**: Consider making a late allocation of GST exemption where the assets gifted to a trust have decreased in value (or have been distributed to non-skip persons) between the date of the gift and the date of filing the gift tax return. For example, assume the donor makes a $1 million gift of property to a GST trust on January 1, 2015. Assume the value of the property decreases in value to $800,000 by April 2016 (or, alternatively, $200,000 of assets are distributed to non-skip persons). When the return is filed, if the donor allocates GST exemption on the timely filed return, then the donor will use $1 million of GST exemption because the allocation is treated as being made as of January 1, 2015. However, if the donor elects out of the allocation of GST exemption on the timely filed return, and then files for a late allocation after filing the initial return, the donor will use only $800,000 of GST exemption to make the trust completely exempt.

D. Automatic Allocations of GST Exemption at Death

1. Section 2632(e) provides that any unused GST exemption remaining at death will be automatically allocated first to a direct skip occurring at death and second to trusts with respect to which the decedent is the transferor (i.e., trusts created at death or during life) and which may have a generation-skipping transfer occur after the decedent's death.
    a. If there are multiple transfers or trusts to receive the automatic allocation, then the unused GST exemption is allocated pro rata based on the nonexempt portions of such properties or trusts.
    b. Automatic allocation is generally effective as of due date for filing the Form 706 and occurs whether or not an estate tax return is required to be filed. Treas. Reg. § 26.2632-1(d)(2). Note that the effective date of an automatic allocation at death is the due date of the return. This is different from the effective date of an *affirmative* allocation by the executor, which is the decedent's date of death.
2. **TIP:** If you are preparing or reviewing a 706-GS(T) or 706-GS(D) for a trust which is not entirely GST exempt, consider reviewing the transferor's estate tax return (if any) or estate (if possible) to determine whether the decedent's unused GST exemption was automatically allocated to the trust pursuant to § 2632(e).

E. Late Allocations of GST Exemption at Death

1. Treas. Reg. § 26.2632-1(d)(1).
2. Executor can make a late allocation of a decedent's GST exemption to lifetime transfers on a Form 706 or Form 709 filed on or before the due

date of the transferor's estate tax return. The allocation will be effective as of the date of filing.

3. **TIP:** An executor should review the trusts created during the decedent's lifetime for which the decedent is considered the transferor for GST purposes when determining how the decedent's remaining GST exemption at death should be allocated. Depending on the events between the date of the lifetime transfers and the decedent's death, it may be more tax efficient to make a late allocation of exemption to an existing trust rather than transfers occurring at death.

F. Retroactive Allocation of GST Exemption

1. Section 2632(d) provides that if a non-skip person has an interest in a trust, then the transferor may make an allocation of GST exemption to any previous transfer to the trust on a chronological basis IF such person:
    a. is a lineal descendant of a grandparent of the transferor or transferor's spouse or former spouse;
    b. is assigned to a generation below the transferor; and
    c. predeceases the transferor.
2. If the allocation is made on a timely filed return for the year of the non-skip person's death, then the allocation is treated as if it was made on a timely filed return for each transfer made to the trust and the allocation is effective immediately prior to the non-skip person's death. The amount of the transferor's unused GST exemption available to allocate is determined immediately before the non-skip person's death.
    a. Retroactive allocation allows for the avoidance of GST tax where a non-skip person, such as a child, dies prior to the donor.
    b. For comparison, a "late allocation" made immediately after the non-skip person's death would require an allocation of an amount of GST exemption equal to the value of the trust property on the date the return is filed, rather than just the amount of the contributions, to make it GST exempt.
3. The non-skip person's interest can be present or future
4. Example: In 2011, donor transfers $1,000,000 cash in trust for child during his lifetime. The trustee has discretion to make distributions to the child and, upon the child reaching age 45, all remaining property will be distributed outright to him or her. The child is given a testamentary limited power of appointment among his descendants, and any unappointed property passes to the child's descendants, per stirpes. Assume the Donor does not allocate GST exemption to the transfer and no GST exemption is automatically allocated under § 2632(c). Assume further that the child dies in 2014 at age 44 when the trust is worth $1.5 million. Since no GST exemption was allocated to the trust, a taxable termination would occur upon the child's death as the trust property passes

to the grandchildren. However, GST tax can be avoided by having the donor make a retroactive allocation of GST exemption to the trust. If the retroactive allocation is made on a return filed by the due date for a 2014 gift tax return, the amount of GST exemption necessary to fully exempt the trust from the GST tax will be $1,000,000, the value of the gift to the trust as of the date such gift was originally made.

5. **TIP:** Whenever filing a Form 706-GS(D), 706-GS(D-1) or 706-GS(T) for a generation-skipping transfer that is subject to GST tax, consider whether a retroactive allocation is available to avoid the tax.

G. Predeceased ancestor exception

1. The predeceased ancestor exception is a special provision that determines the generation in which a person is placed for GST purposes when a descendant has predeceased the transferor.
2. Generally, Section 2651(e) provides that if:
   a. a donee is a descendant of a transferor's parent (or a descendant of the transferor's spouse's (or former spouse's) parent); and
   b. the donee's parent who is a lineal descendant of the transferor's parent (or the transferor's spouse's (or former spouse's) parent) is deceased at the time the transfer is subject to gift or estate tax;

   then, the donee will be treated as if he or she is in the generation that is one below that of the transferor or the generation assignment of the youngest living ancestor of such donee who is also a descendant of the transferor's parent (or the transferor's spouse's (or former spouse's) parent) and the generation assignment of any donee descendant shall be adjusted accordingly.
3. Ninety (90) day rule – An individual who dies no later than 90 days after a transfer occurring by reason of the death of the transferor is treated as having predeceased the transferor. Treas. Reg. § 26.2651-1(a)(2)(iii).
4. Disclaimers by an individual do not invoke the predeceased ancestor rule, even if local law treats the individual as predeceased as a result of the disclaimer. Treas. Reg. § 26.2651-1(a)(2)(iv).
5. **TIP:** When determining whether the predeceased ancestor exception applies, one must look at who was living and deceased *at the time the transferor was subject to gift or estate tax*. For example, if donor makes a gift to a trust for the benefit of child and, upon child's death, the remainder passes to the grandchildren, the predeceased ancestor exception does not apply if child is alive at the time of the gift but predeceases the donor. Treas. Reg. § 26.2651-1(a)(2)(iii). However, if a donor sets up a QTIP Trust for spouse, with a remainder to descendants per stirpes, and a child dies after the contribution, but before spouse dies, then the predeceased ancestor exception would apply because the critical time to consider is the date of the spouse's death (i.e., the date the trust property was last subject

to estate tax) when the spouse became the transferor for GST purposes. See Treas. Reg. § 26.2651-1(c) Ex. 3. (note: if the first deceased spouse made a reverse QTIP election under § 2652(a)(3), then the transferor would not change at the second spouse's death and the predeceased ancestor exception would not apply. Treas. Reg. § 26.2651-1(c) Ex. 4.).

H. Requests for Relief to Allocate, or Elect out of Automatic Allocation of, GST Exemption

1. If GST exemption was not timely allocated to a trust, either by the donor or automatically pursuant to § 2632, then a donor may be able to obtain relief by requesting from the Service a grant of an extension of time to make a timely allocation of GST exemption. Making a timely allocation, rather than a late allocation, can be extremely important because assets will be valued as of the date of the initial contribution to the trust if the allocation is timely, versus the date of filing if the allocation is late. Therefore, a timely allocation means that all appreciation and income after the contribution would be exempt.
2. Section 2642(g), enacted in 2001, generally provides that the Secretary shall by regulation prescribe circumstances and procedures under which extensions of time will be granted to make an allocation of GST exemption or an election out of the automatic allocation of GST exemption under § 2632.
3. IRS Notice 2001-34 stated that such relief will be granted pursuant to the procedures under Treas. Reg. § 301.9100-3.
4. Treas. Reg. § 301.9100-3 provides that requests for relief will be granted when the taxpayer provides evidence to establish that he or she acted reasonably and in good faith, and the grant of relief will not prejudice the interests of the government.
    a. Reasonable action and good faith may be shown where:
        1. Relief is requested before the failure is discovered by the IRS;
        2. Taxpayer's failure to make the election was due to intervening events beyond the taxpayer's control;
        3. Taxpayer's failure to make the election was because the taxpayer was unaware of the necessity of the election after exercising reasonable diligence (taking into account the taxpayer's experience and complexity of the issue or return);
        4. Taxpayer reasonably relied on written advice of the IRS; or
        5. Taxpayer reasonably relied on a qualified tax professional, and the tax professional failed to make, or advise the taxpayer to make, the election.

(a) Reliance is not reasonable if taxpayer knew or should have known that tax professional was either not competent to render advice or aware of all relevant facts.

b. A taxpayer is deemed not to have acted reasonably and in good faith if:

1. Taxpayer seeks to alter a return position for which an accuracy-related penalty could be imposed and the new position requires or permits a regulatory election for which relief is requested;
2. Taxpayer was informed of the required election and related tax consequences, but chose not to make it; or
3. Taxpayer uses hindsight in requesting relief (e.g. facts have changed that make the election advantageous to the taxpayer and the taxpayer cannot provide strong proof that request for relief did not involve hindsight).

c. Government interests are prejudiced if:

1. Granting relief would result in the taxpayer having a lower tax liability in the aggregate for all tax years affected by the election than if the election was timely made; or
2. The limitations period for the tax year in which the regulatory election should have been made or any tax years affected by the election had it been timely made are closed.

d. A taxpayer files for 9100 relief by submitting a private letter ruling request together with affidavits and additional information. See. Treas. Reg. § 301.9100-3(e).

e. The following is a list of situations where 9100 relief has been granted by the Service to allow a timely allocation of GST exemption:

1. Form 709 reported the gift as being made to the wrong trust resulting in no GST exemption allocation being made. PLR 201432004.
2. Form 709 was not timely filed because accountant believed no returns were due since no gift tax was due. PLR 201434019.
3. In preparing Form 709, the taxpayer's tax professional incorrectly reduced the amount of GST exemption allocated to each transfer by the amount of the annual exclusion. PLR 201451025.
4. Form 709 was timely filed, but the taxpayers' accountants failed to advise them to allocate their GST exemption. PLR 201526005.

        5. Form 709 was not filed by the taxpayer's accountant. PLR 201527002.
    f. It appears the Service is rather generous in granting 9100 relief to allow for a timely allocation of GST exemption as long as the return preparer admits his or her mistake.

5. Rev. Proc. 2004-46 provides a simplified method to obtain an extension under Treas. Reg. § 301.9100-3 in lieu of the letter ruling process for annual exclusion transfers made prior to the enactment of § 2642(g). Specifically, relief under Rev. Proc. 2004-46 requires:
    a. On or before December 31, 2000, the taxpayer made a gift to a trust from which a generation-skipping transfer may be made;
    b. At the time the taxpayer requests relief, no taxable distributions or taxable terminations have occurred;
    c. The transfer qualified for the annual exclusion and did not exceed the annual exclusion amount;
    d. No GST exemption was allocated to the transfer, whether or not a Form 709 was filed; and
    e. A new Form 709 is filed reporting the transfer and the allocation of GST exemption.

6. Proposed regulations were promulgated under § 2642 describing the circumstances and procedures under which an extension of time will be granted under § 2642(g)(1), which was intended to replace the 9100-3 procedures. See Prop. Treas. Regs. §§ 26.2642-7 and 301.9100-3(g). *The Proposed Regulations have yet to be finalized, however, and are not effective until finalized.* The proposed regulations are very similar to the procedures required under 9100-3:
    a. Like 9100 relief, a taxpayer seeking relief under the proposed regulations must demonstrate that they acted reasonably and in good faith, and that the grant of relief will not prejudice the interests of the Government.
        1. The proposed regulations contain a non-exhaustive list of factors that may constitute reasonableness and good faith, situations where a taxpayer has not met the standard of reasonableness, good faith and lack of prejudice, and factors considered to determine whether the interests of the Government would be prejudiced. Prop. Treas. Regs. §§ 26.2642-7(d)(2), 26.2642-7(d)(3), 26.2642-7(e). These factors and situations are largely the same as those considered for 9100 relief.
    b. Like 9100 relief, a taxpayer files for relief under the proposed regulations by submitting a private letter ruling request together

with affidavits and other information. Prop. Treas. Reg. § 26.2642-7(h).

c. Like 9100 relief, if an extension of time is granted under the proposed regulations, the allocation of GST exemption is considered effective as of the date of the transfer. Prop. Treas. Reg. § 26.2642-7(b).

7. Until the Proposed Regulations are finalized, taxpayers should continue to use 9100-3 to seek relief.

I. Estate Tax Inclusion Period (ETIP) Rules

1. If transferred property would be includible in the donor's estate if the donor had died immediately after the transfer (other than the three (3) year look back period), the skip will be treated as having been made at the end of the estate tax inclusion period (ETIP), rather than at the time of the transfer.
2. The gift portion of the transfer is to be reported on a Form 709 filed for the year of the actual transfer.
3. The GST portion of the transfer is reported at the close of the ETIP period.
4. Therefore, if the transferor or transferor's spouse retain certain rights or interest in a trust, then any GST exemption allocation will not be effective until the ETIP closes. Treas. Reg. § 26.2632-1.
5. Because there is a delay in the automatic allocation, more exemption may need to be used than if an election out and earlier affirmative allocation could have occurred.
6. **TIP:** The tax return preparer should track the inclusion period to effectively consider if at the close of the ETIP, whether the automatic allocation rules should be used or would they cause a waste of exemption because the trust is unlikely to benefit a skip person.
7. If the ETIP terminates during the transferor's life, the GST exemption may be allocated on a timely filed gift tax return for the year in which the ETIP terminates.
8. Although an allocation may be made on the Form 709 that reports the gift, the allocation will not be effective until the end of the ETIP.
   a. The allocation will be irrevocable when the Form 709 is filed.
   b. The inclusion ratio will not be set at the time of the filing, but rather at the ETIP close.
9. The donor may include a statement regarding an election out of the automatic allocation rules on the Form 709 that reports the gift.
10. If the ETIP terminates when the transferor dies, the GST exemption may be allocated on the Estate Tax Return, Form 706.
11. A transferor cannot allocate GST exemption, before his or her retained interest terminates, to a grantor retained annuity trust or a qualified personal residence trust.

VII. FILING ESTATE TAX RETURNS FOR PORTABILITY

A. Portability was made permanent with the American Taxpayer Relief Act of 2012. The final regulations were issued on June 12, 2015. T.D. 9725.

B. A deceased spouse that does not fully utilize his applicable exclusion amount may have such unused amount "ported" to his surviving spouse.

1. Portability election is deemed to be made by timely filing a completed Estate Tax Return, Form 706, unless the executor opts out of portability by affirmatively stating so on the return or in a statement attached to the return. Treas. Reg. § 20.2010-2(a)(1).

2. The due date of an estate tax return filed to elect portability is nine months after the decedent's date of death or the last day of the period covered by an extension. §§ 6075(a) and 6018(a).

3. Extensions of Time

a. An extension of time to elect portability pursuant to Treas. Reg. § 301.9100-3 is not available to estates that are required to file an estate tax return under § 6018(a) because the due date for the portability election is prescribed by statute and § 301.9100-3 applies only to an election whose due date is prescribed by regulation. §§ 2010(c)(5)(A), 6075(a); Treas. Reg. § 301.9100-1(b).

b. An extension of time to elect portability pursuant to Treas. Reg. § 301.9100-3 is available to estates that are under the § 6018 value threshold for being required to file an estate tax return, since the due date is prescribed by regulation. Rev. Proc. 2014-18, 2014-7 IRB 513, section 2.03. See e.g., PLR 201535004.

4. **CAUTION**: After granting 9100 relief to extend the time for filing a return where the estate is under the § 6018 threshold, if it is later determined that, based on the value of the gross estate and taking into account any taxable gifts, decedent's estate is required to file an estate tax return pursuant to § 6018(a), the Commissioner can deem the original relief null and void. PLR 201532002 and PLR 201414001.

C. As a result of the portability filing, the surviving spouse's exclusion, for both gift and estate tax purposes, is the sum of their own basic exclusion amount, plus the ported DSUE. § 2010(c)(2).

1. The basic exclusion amount for 2015 is $5,430,000 ($5,000,000 adjusted for inflation annually after 2011). § 2010(c)(3).

2. Under § 2010(c)(4), the DSUE amount is the lesser of:

a. The basic exclusion amount; or

b. The excess of:

1. The applicable exclusion amount of the surviving spouse's last deceased spouse, over

2. The amount with respect to which the tentative tax is determined under § 2001(b)(1) on the estate of such deceased spouse.

D. Only the estate's appointed executor (i.e., personal representative) is permitted to file the estate tax return and make the portability election or opt out of portability if an executor is appointed. If there is no appointed executor, then any person in actual or constructive possession of any property of the decedent may make the election by timely filing an estate tax return. § 2010(c)(5); Treas. Reg. § 20.2010-2(a)(6).

E. The election, once made, is irrevocable. § 2010(c)(5).

F. Generally, a return filed for an estate that is not otherwise required to file an estate tax return under § 6018 must comply with the reporting requirements that apply to estate tax returns required to be filed under § 6018, except as follows:

1. With respect to property qualifying for the marital deduction under § 2056 or § 2056A, or the charitable deduction under § 2055(a), an executor is not required to report a value, but the executor must provide an estimate of the fair market value of the total gross estate, including the marital or charitable deduction property, on the return.
2. This rule does not apply to marital or charitable deduction property if:
    a. The value of such property relates, affects or is needed to determine the value passing from the decedent to someone other than the recipient of such property;
    b. The value is needed to determine the estate's eligibility for a provision of the Code for which the value of the property or gross estate must be known;
    c. Less than the entire value of an interest in property includible in the gross estate is marital or charitable deduction property; or
    d. A partial disclaimer or partial QTIP election is made over the marital or charitable deduction property. Treas. Reg. § 20.2010-2(a)(7)(ii)(A).
3. **TIP**: If an executor files a complete and properly prepared Form 706 that shows a DSUE amount of zero at the time of the return's timely filing and does not opt out of portability; and also files a protective claim for refund attributable to a claim against the estate; then when the estate subsequently becomes entitled to a Section 2053 deduction which reduces the estate tax and results in unused exemption, then the executor has elected portability in accordance with the regulations and the recomputed DSUE amount will be available to the decedent's surviving spouse. Treas. Regs. §§ 20.2010-2(b) and 20.2010-2(a)(7).

G. Surviving spouse may use the ported DSUE amount for any lifetime gifts or upon death.

1. The ported DSUE amount is used before the taxpayer's basic exclusion amount. Treas. Reg. § 25.2505-2(b)
2. The surviving spouse may only use the DSUE amount ported from the last deceased spouse.
   a. Illustratively, surviving spouse ("SS") receives DSUE from predeceased spouse ("D"); SS marries new spouse ("NS"); NS predeceases SS.
   b. Any unused/remaining DSUE amount that SS received from D is lost.
   c. SS may still receive a DSUE from NS.
3. Internal Revenue Service's right to examine the first deceased spouse's DSUE amount remains open until the end of the statute of limitations applicable to the surviving spouse's tax compliance that reflected a ported amount.
4. Form 709, Schedule C, reconciles the inclusion of a portable DSUE amount.
   a. Taxpayer provides information associated with the deceased spouse's death and indicates whether a portability election was made.
   b. Taxpayer separately indicates the DSUE amounts used for each of their prior deceased spouses.
   c. Taxpayer indicates the year of the gift that uses the DSUE amount.

VIII. RETURN PREPARER REPORTING STANDARDS AND IRS DISCLOSURE FORMS

A. Generally, a tax return preparer must have substantial authority for a position taken on a return to avoid accuracy-related penalties under § 6694.

1. "Substantial authority" is an objective standard based on an analysis of the law and application of the law to the relevant facts. It is less than the 'more likely than not' standard, but more than the 'reasonable basis' standard. Treas. Regs. §§ 1.6694-2(a)(1), 1.6662-4(d)(2).

B. If a position is adequately disclosed, however, in accordance with the requirements of § 6694, then the tax return preparer can avoid certain accuracy-related penalties if there is a reasonable basis for the position.

1. "Reasonable basis" is a significantly higher standard than not frivolous or not patently improper, but not as high as substantial authority. It is not satisfied, however, by a position that is merely arguable. It must be based on one or more authorities. Treas. Reg. § 1.6662-3(b)(3).
2. The relevant options for satisfying the adequate disclosure requirements vary slightly depending upon whether the return preparer is a "signing tax return preparer" or "nonsigning tax return preparer". Treas. Reg. § 1.6694-2(d)(3).

a. Signing tax return preparer can satisfy adequate disclosure by:
   1. Disclosing the position on Form 8275 or 8275-R filed with the return;
   2. Disclosing the position in accordance with the requirements listed in the relevant annual revenue procedure issued by the IRS; or
   3. Providing the taxpayer with the prepared return that includes a Form 8275 or 8275-R (note: there is no requirement for the taxpayer to file the 8275 or 8275-R when the taxpayer files the return).

b. Nonsigning tax return preparer can satisfy adequate disclosure by
   1. Disclosing the position on Form 8275 or 8275-R filed with the return;
   2. Disclosing the position in accordance with the requirements listed in the relevant annual revenue procedure issued by the IRS; or
   3. Either:
      (a) Nonsigning preparer advises the taxpayer of any opportunity to avoid penalties under § 6662 that could apply to the position and of the standards for disclosure, and contemporaneously documents the advice in the file; or
      (b) Nonsigning preparer advises the signing preparer that disclosure under § 6694(a) may be required, and contemporaneously documents the advice in the file.

C. Form 8275 (see attached Exhibit 8)
   1. Used by taxpayers and tax return preparers to disclose items or positions, *except those taken contrary to a regulation*, on a tax return.

D. Form 8275-R (see attached Exhibit 9)
   1. Used by taxpayers and tax return preparers to disclose items or positions taken on a tax return *that are contrary to a regulation*.

E. In the authors' experience, there is no indication that filing Form 8275 or 8275-R with a return increases the audit risk.

F. *Note:* Taxpayers are subject to accuracy-related penalties under § 6662, some of which can be mitigated by filing Form 8275 or 8275-R.

IX. REPORTING A BENEFICIARY'S BASIS IN PROPERTY RECEIVED FROM DECEDENT

A. On July 31, 2015, President Obama signed the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 into law.

1. The Act contains revenue provisions requiring, *inter alia*, taxpayers acquiring property from a decedent to use the finally determined value for Federal estate tax purposes as their basis for income tax purposes.
2. Under newly-enacted § 6035, the executor of any estate required to file a return under § 6018(a) must furnish, both to the IRS and each beneficiary acquiring any property interest included in the decedent's gross estate, a statement identifying the value of each interest in such property as reported on the estate tax return. It appears a statement of value is not required to be furnished for returns that are not required to be filed under § 6018, but are filed only for portability.
3. Each person required to file a return under § 6018(b) must furnish, both to the IRS and each other person who holds a legal or beneficial interest in the property, a statement identifying the value of each interest in such property as reported on the estate tax return. § 6035(a)(2).
4. Under newly-enacted § 1014(f), the basis of property reported for income tax purposes must not exceed the value of the property determined and reported in a decedent's estate tax return.
5. In accord, the beneficiary must use § 1014(f) value for depreciating or amortizing assets.
6. These new requirements apply to property reported on any estate tax return filed after July 31, 2015, whether the return is filed timely, on extension or late.
7. A person in possession of an asset is required to provide the basis information, if the executor does not have the information.

B. Defining Finally Determined Value (FDV)

1. If the IRS fails to audit the Form 706 within the statute of limitations, the value reflected on the filed Form 706 is the FDV. § 1014(f)(3).
2. If the IRS audits the Form 706 and changes the value and the taxpayer agrees to the changes, the value reflected on the IRS' change report is the FDV.
3. If the IRS audits the Form 706 and the taxpayer's time for contesting the audit value has run, the value reflected on the IRS' report is the FDV.
4. If the parties litigate and a court rules on the value, then the court's holding is the FDV.
5. Estate tax returns that include portability election are included in this directive. However, the basis consistency rule appears to not apply to

returns filed in order to elect portability of a deceased spouse’s unused exclusion amount.

C. Information Regarding Beneficiaries Acquiring Property From a Decedent, Form 8971 and Schedule A, Statement Requirements

1. The statement must be furnished no later than the earlier of the due date of the return or the date the return is filed.
2. The same value information must be sent to the IRS and to each person acquiring any interest in property included in the decedent’s gross estate.
3. Pursuant to § 6035(a)(3)(A), Form 8791 (including all attached Schedule(s) A) must be filed with the IRS and only the Schedule A is to be provided to the beneficiary, no later than the earlier of:
    a. thirty (30) days after the date which the Form 706 or Form 706-NA is required to be filed (including extensions) with the IRS; or
    b. thirty (30) days after the date the Form 706 or Form 706-NA is filed with the IRS.
4. If the first Form 706 or Form 706-NA is filed both after the form’s due date (including extensions), then From 8971 and Schedule(s) A are due thirty (30) days after the filing date.
5. Form 8971 is a separate filing requirement from the estate’s Form 706 of 706-NA, and should not be attached to the respective estate tax return.
6. Each statement must provide the following information to the IRS:
    a. each person who holds a beneficial interest in property subject to the reporting;
    b. the property’s description as report on Form 706 or Form 706-NA;
    c. the property’s value as reported on Form 706 or Form 706-NA; and
    d. other information that the IRS may prescribe.
7. A beneficiary can be provided Schedule A:
    a. In person to an individual beneficiary;
    b. In person to the trustee(s) of a beneficiary trust;
    c. In person to the executor(s) of a beneficiary’s estate;
    d. By email;
    e. By U.S. mail to the beneficiary’s last known address; or
    f. By private delivery service to the beneficiary’s last known address.
8. The estate’s personal representative (or other person required to file) must certify on Form 8971, the date on which Schedule A was provided to each beneficiary and should keep proof of mailing, proof of delivery, acknowledgment of receipt, or other relevant information.
9. Where there are multiple fiduciaries for a trust or estate, providing Schedule A to one (1) fiduciary is enough to meet the requirement.
10. If the initial Form 8971 and Schedule(s) A identify several beneficiaries who might receive the same property, the estate may, but is not required

to, file a supplemental Form 8971 and Schedule(s) A to specify the actual distribution of that property among the identified beneficiaries.

11. If the Statement Values are changed or adjusted on exam, a supplemental statement must be filed with the IRS and provided to the beneficiary within thirty (30) days after the adjustment is made.
12. In September 2016, the IRS released the revised instructions to Form 8971 and Schedule A.

D. Beneficiaries of Property That Did Not Increase the Estate Tax Due
   1. The rules are not applicable to a beneficiary that receives property that did not increase the estate tax due.
   2. If property qualified for the marital deduction, then a statement to the spouse may not be subject to these rules.
      a. Marital deduction property that is includible in the taxable estate of the surviving spouse will increase the estate tax in the surviving spouse's estate.
      b. Thus, marital deduction property can be subject to basis consistency requirements at the death of the surviving spouse.
   3. In accord, if property qualified for the charitable deduction, then a statement to such charities is not subject to these rules.
   4. Property that was includible in an estate that was not required to file a Form 706 (i.e. a portability filing only) is not subject to these rules. However, the executor should still provide basis information.

E. Beneficiary's Subsequent Reporting of Basis
   1. If a beneficiary's basis claim on his income tax return is inconsistent with the basis provided on the executor's statement, then a twenty percent (20%) penalty is assessed on the underpayment of income tax.
   2. The penalty only applies where the beneficiary's basis for income tax purposes exceeds the basis as determined under § 1014(f).
   3. A six (6) year statute of limitations applies in the case of an overstatement of basis. § 6501(e)(1)(B).

F. Penalty for Failure to File Statement: §§ 6662, 6721, & 6722
   1. Under Section 6662, beneficiaries who report basis in property that is inconsistent with the amount on Schedule A may be liable for a 20% accuracy-related penalty.
   2. Under Section 6721, if the personal representative fails to file a correct Form 8971 and/or Schedule A by the due date and reasonable cause is not shown, a penalty may be imposed. The penalty applies if there is:
      a. A failure to timely file;
      b. A failure to include all information required to be shown on the form or schedule;
      c. A failure to include correct information on the form or schedule; or

d. A failure to file a correct supplemental Form 8971 and/or Schedule A by the due date.

3. Under Section 6722, if the personal representative fails to provide a correct Schedule A to a beneficiary and does not show reasonable cause, a penalty may be imposed.
4. The amount of the penalty, under both Sections 6721 & 6722, depends on when the correct Form 8971 with Schedule(s) A is filed or provided. The penalty is as follows:
   a. $50 per Form 8971 (including all Schedule(s) A) if it is filed within thirty (30) days of the due date;
   b. $260 per Form 8971 (including all Schedule(s) A) if it is filed more than thirty (30) days after the due date or if it is not filed.
   c. Though the statement may need to be sent to several beneficiaries, the filing of the statement with the IRS may be viewed as only one information return for penalty purposes.
   d. If any failure to file is due to intentional disregard of the requirements to file, the minimum penalty is at least $530.
   e. Significantly higher penalties (more than $532,000) apply where the average annual gross receipts for the three (3) most recent tax years (or for the period you were in existence, if shorter) ending before the calendar year in which the information returns were due are more than $5 million.
5. Inconsequential errors or omissions are not considered a failure to include correct information.
   a. An inconsequential error or omission does not prevent or hinder the IRS from processing the Form 8971 and Schedule(s) A.
   b. An inconsequential error or omission cannot reasonably be expected to prevent or hinder the beneficiary from timely receiving correct information and using the information to report basis on the beneficiary’s own return.
6. **CAUTION**: Errors or omissions that ARE NEVER inconsequential are those related to:
   a. A taxpayer’s identification number;
   b. A beneficiary’s surname;
   c. The value of the asset the beneficiary is receiving from the estate; and
   d. A significant item in a beneficiary’s address.
7. An exception to the penalties may be allowed where it is shown to be due to reasonable cause and not to willful neglect.
   a. It must be shown that the failure was due to an event beyond the taxpayer’s control or due to significant mitigating factors.

b. Also must show that the fiduciary acted in a responsible manner and took steps to avoid the failure.

8. **TIP**: There are special rules whenever you need to submit a Power of Attorney, Form 2848:
   a. The personal representative, not the estate, is the "taxpayer" listed on line 1;
   b. The personal representative's tax identification number, is used, not the estate's EIN;
   c. Description of the Matter column: "Civil Penalties"
   d. Tax Form Number column: Form 8971/Schedule A
   e. Year or Period column: use the decedent's date of death, in the following format > YYYYMM