

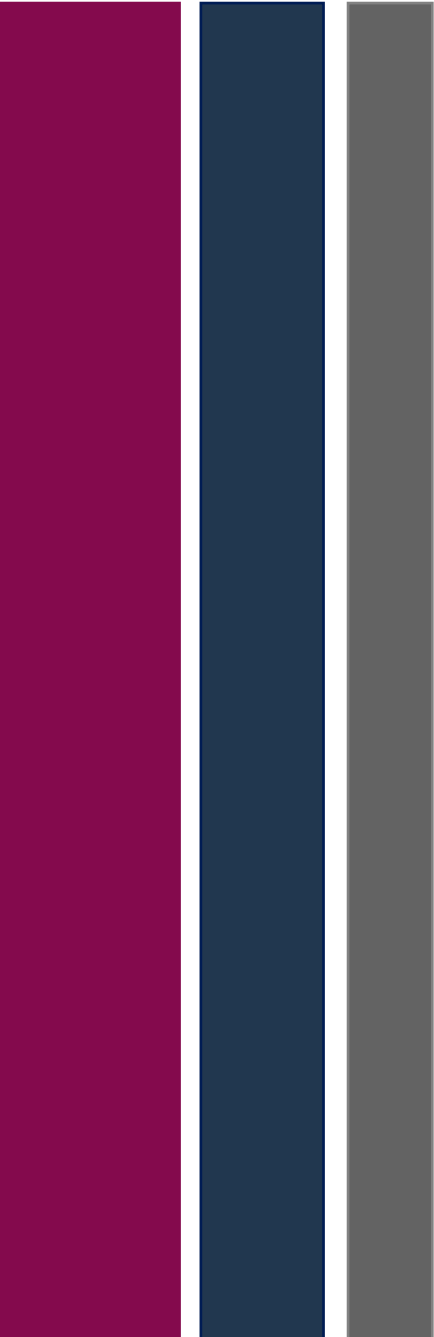


# Consistent Basis Reporting Between Estates and Beneficiaries

Delaware Trust Conference  
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# Congress Feared Inconsistent Reporting of Values Between Estate and Income Tax Reporting

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- Enacted new legislation as part of the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 (P.L. 114-41) on July 31, 2015
  - Section 1014(f) – Basis Consistency Rules
  - Section 6035 – Executor Reporting Requirements – Form 8971
  - Section 6662(k) – 20% Accuracy Related Penalty Provision
  - Section 6724(d)(1)(D) – Failure to File Penalty Provision



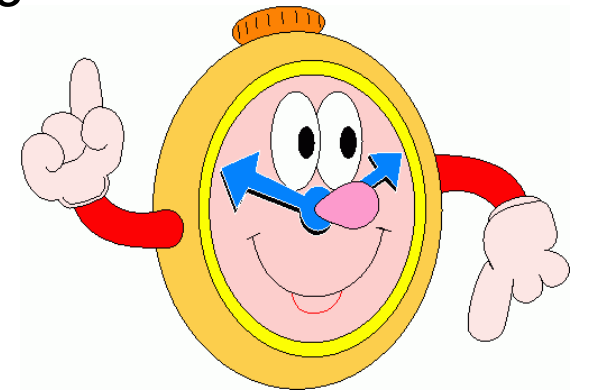
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# Timeline and Delayed Implementation

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- Reporting requirement was effective for estate tax returns filed on or after August 1, 2015 – just one day after the Act was passed and otherwise would have required the first filings only 30 days later.
- Practitioners needed more time to understand and digest new rules and requirements
- Treasury and IRS needed more time to develop guidelines and forms
- Notice 2015-57 delayed implementation until February 29, 2016



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# Further Delays

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- Draft Form 8971 released on 12/18/2015
- Instructions to Form 8971 issued on 1/16/2016
- Final Form 8971 released on 1/28/2016
- On February 11, 2016 Notice 2016-19 further delayed implementation until 3/31/2016
- Proposed Regulations (T.D. 9757) formally issued and recorded in Federal Register on 3/4/2016
- On March 23, 2016, Notice 2016-27 again further delayed implementation until 6/30/2016
- Revised instructions as of September 2016 – these instructions specify no attachments to Schedule A

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# Basis Consistency – Section 1014(f)

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Taxpayer's initial basis in property acquired from a decedent

- Cannot exceed the property's "final value" for estate tax purposes
- If final value has not been determined – use amount reported on new Form 8971
- Rule only applies to property which increases the estate's liability (after credits) by reason of inclusion of asset in gross estate

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# Basis Consistency – Exclusions

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- Assets qualifying for marital deduction
- Assets qualifying for charitable deduction
- Tangible personal property for which an appraisal is not required

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# “Final Value”

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- Final value is determined if
  - The value has been reported on Form 706 filed with the IRS and is not contested by the IRS prior to the expiration of the statute of limitations
  - The value is specified by the IRS and not contested by the executor
  - The value is determined by a court or pursuant to a settlement agreement with the IRS
- What happens when a beneficiary has better information than the executor with respect to determining value?





# Post-Death Adjustments

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- Proposed regulations clarify that post-death adjustments are permitted in determining value for purposes of Section 1014
  - Capital improvements
  - Depreciation
  - Amortization
  - Adjustment to the basis of partnership or S corporation interest

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# Possible Trap and Assessment of Underpayment Penalty

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- Taxpayer sells inherited property for \$175,000 18 months after timely estate return is filed using a basis equal to the value shown on the estate return of \$150,000 (gain is \$25,000)
- Estate return is audited by IRS one year later and the final value is determined to be \$100,000
- Taxpayer has overvalued the property and would be subject to tax on the additional gain of \$50,000 and the accuracy-related penalty



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# “Zero-Basis” Rule

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Proposed Regulation 1.1014-10(3)(i)(B) -

- Applicable to newly discovered or previously omitted assets from Form 706
  - Final value (basis) is zero if return has been filed, the SOL has run and the omitted property had not been reported
  - Final value (basis) is zero if no return has been filed by the due date for filing and the inclusion of the after-discovered or omitted property would have generated or increased the estate tax, until such time as the estate tax return is filed and the final value is determined
  - If the statute of limitations has not expired and the executor reports the property on a supplemental estate tax return – then the final value (basis) is determined under the general rules for Section 1014(f)

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# “Zero-Basis” Rule - Continued

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Taxpayer selling property that has been omitted from the 706 would have a zero basis

- 100% gain
- Could be subject to penalties
- Could amend if value is subsequently established and SOL has not expired
- Seems like a harsh penalty for beneficiary if executor inadvertently misses an asset
- Executors should consider hold-harmless clauses for inadvertent omissions
- Does this entire provision exceed IRS’s statutory authority?

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# Section 6662(a)(8) – Accuracy-Related Penalty

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## Section 6662

(a) If this section applies to any portion of an underpayment of tax required to be shown on a return, there shall be added to the tax an amount equal to 20% of the portion of the underpayment to which this section applies.

(b) Portion of underpayment to which section applies: This section shall apply to the portion of any underpayment that is attributable to one or more of the following:

- (8) Any inconsistent estate basis

Section 6662(k) – For purposes of this section, there is an “inconsistent estate basis” if the basis of property claimed on a return exceeds the basis as determined under section 1014(f).

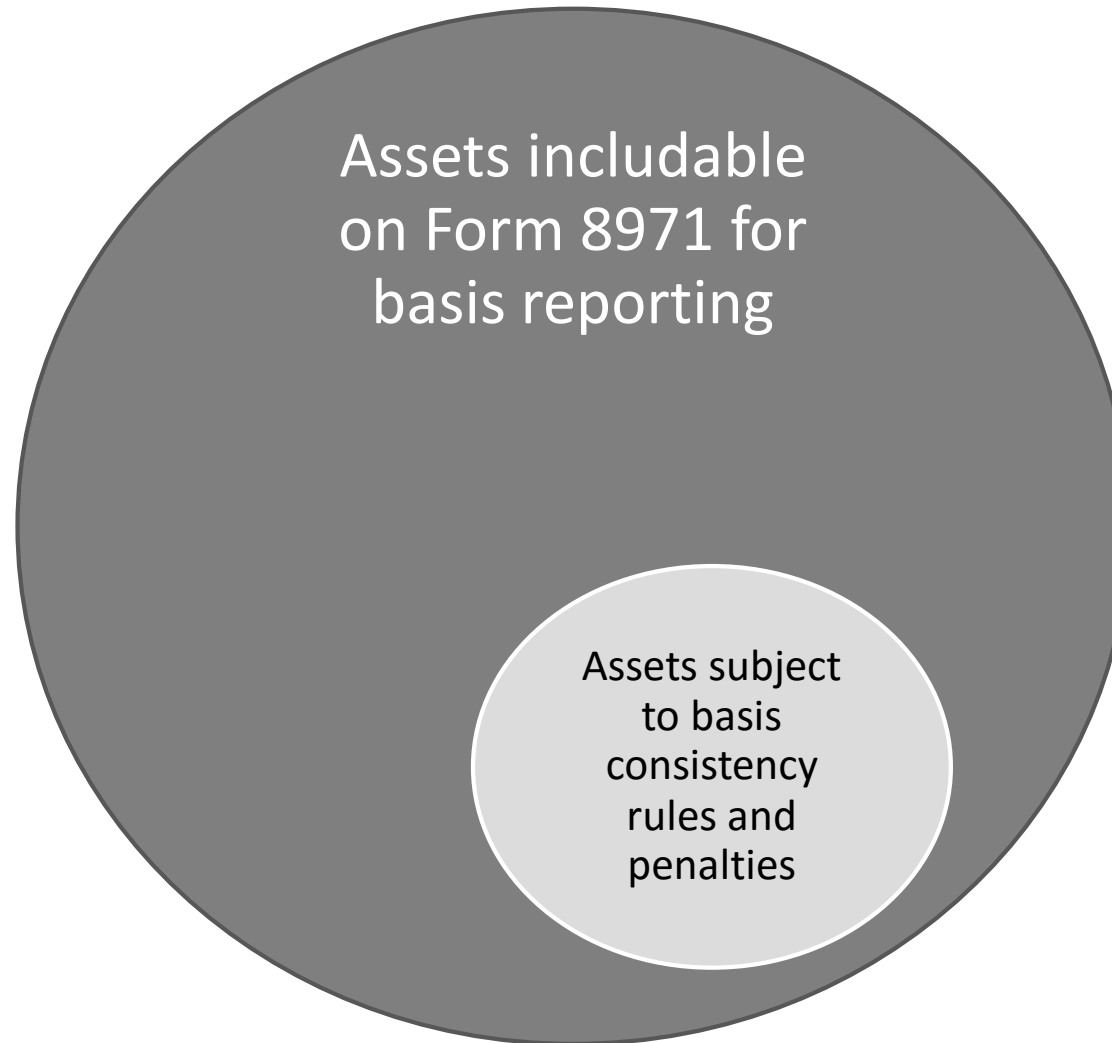
# Accuracy-Related Penalty

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- Section 1.6662-8: Inconsistent estate basis reporting
- There is an inconsistent estate basis to the extent that a taxpayer claims a basis, without regard to the adjustments described in §1.1014-10(a)(2), in property described in paragraph (c) of this section that exceeds that property's final value as determined under §1.1014-10(c).
  - The language “ ... claims a basis, without regard to the adjustments described in §1.1014-10(a)(2) ...” is looking for the initial basis to be consistent with the Form 706.
  - Taxpayers won't be penalized for basis changes that occur post-death.

# Basis Consistency vs. Basis Reporting

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# New Reporting Requirements for Executors

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## Section 6035 – Form 8971 –

- Executor of an estate or other persons required to file Form 706 or 706-NA is required to file Form 8971 with IRS and provide a copy of Schedule A to each person who receives or could receive property
  - For all estate returns filed and otherwise required to be filed on or after August 1, 2015 (including returns on extension as of 8/1/15)
  - Due within 30 days after the Form 706 is filed (including extension) or should have been filed, whichever is earlier
  - Treasury delayed initial implementation until June 30, 2016
  - Currently no provision for requesting an extension of time to file Form 8971

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# Summary

	706 filed	8971 required	§1014(f) applies
Estate <sup>1</sup> ≤ BEA			
Estate <sup>1</sup> ≤ BEA (portability only)	X		
Estate <sup>1</sup> ≤ BEA (GST allocation only)	X		
Estate <sup>1</sup> ≈ BEA (protective claim)	X		
Estate <sup>1</sup> > BEA (charitable and marital deductions eliminate tax liability)	X	X	
Estate <sup>1</sup> > BEA	X	X	X <sup>2</sup>

BEA = basic exclusion amount (\$5.45m in 2016)

<sup>1</sup>Plus prior gifts

<sup>2</sup>§1014(f) applies to property which increased the estate tax liability

# Exemptions From Filing Requirement

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- If federal estate tax return is otherwise not required to be filed under Section 6018
- If filing solely to make a portability election
- If filing solely to make a GST tax election or allocation
- If estate assets are less than or equal to the exclusion amount and the estate tax return is being filed for protective purposes

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# Providing Schedule A to Beneficiaries

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- Schedule A is part of Form 8971 filed with the IRS
- Also, the Executor is required to separately provide a copy of Schedule A to each beneficiary who is acquiring or could acquire property from the decedent
- If beneficiary is other than an individual –
  - Provide copy to trustee or executor, not the beneficiary
  - Provide copy to business entity, not the owners
- What if beneficiary cannot be located?



# Supplemental Information Returns

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Supplemental Form 8971 and related Schedule A must be filed within 30 days upon a change of information required to be reported that would otherwise render the original filing incomplete.

- Erroneous or incomplete information originally available to the executor
- Discovery of additional property
- Change of identity of current or new beneficiary
- Change in final value of property

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# When a Supplemental Filing is Not Required

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- To correct an inconsequential error or omission
- To specify the actual distribution of assets previously reported as being available to satisfy the interest of multiple beneficiaries



# Subsequent Transfers

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- Proposed regulations require an additional information reporting obligation on the recipient of property previously reported or required to be reported, if that recipient subsequently transfers such property
  - In a non-taxable transaction (e.g. gift) and
  - To a related party
    - Member of transferor's family (spouse, ancestor or lineal descendant of the individual or the individual's spouse or sibling)
    - A controlled entity owned by the transferor or the transferor's family, or
    - A grantor trust as to the transferor

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# Subsequent Transfers - Continued

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- And where basis in the hands of the transferee is determined in whole or in part by the basis with reference to the transferor's basis
- In above situations, the recipient is required to file a Form 8971 with the IRS and provide the transferee with a copy of Schedule A

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# Subsequent Transfers - Continued

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## EXAMPLE:

John inherits 100 shares of ABC stock with a final estate value of \$1,000, which is properly reported on the decedent's estate tax return and on Form 8971 and Schedule A prepared by the executor. John holds the stock for 50 years and then gifts the shares to his son and reports the gift on a timely filed gift tax return. In this case John will also need to file a supplemental Form 8971 with the IRS and provide his son with a copy of Schedule A.

Couldn't the IRS get the same information from the gift tax return that John would have to file?

Has the IRS again overstepped its statutory authority since the law clearly states that the obligation for compliance with Section 6035(a) is with the executor?

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# Penalties

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- Only one penalty will apply for all failures relating to a single filing of a single Form 8971 and the Schedule(s) A required to be filed along with it.
- Each filing of a Form 8971 with Schedule(s) A is a separate filing, regardless as to whether the filing is of the initial Form 8971 and Schedule(s) A or a supplemental Form 8971 and Schedule(s) A.

## Penalties - Continued

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- \$50 per Form 8971 (including all Schedule(s) A) if it is filed within 30 days after the due date.
- \$260 per Form 8971 (including all Schedule(s) A) if it is filed more than 30 days after the due date or if it is not filed.
- If any failure to file a correct Form 8971 or Schedule A is due to intentional disregard of the requirements to file a correct Form 8971 and Schedule(s) A, the minimum penalty is at least \$530 per Form 8971 and the Schedule(s) A required to be filed with it, with no maximum penalty.

## Penalties - Continued

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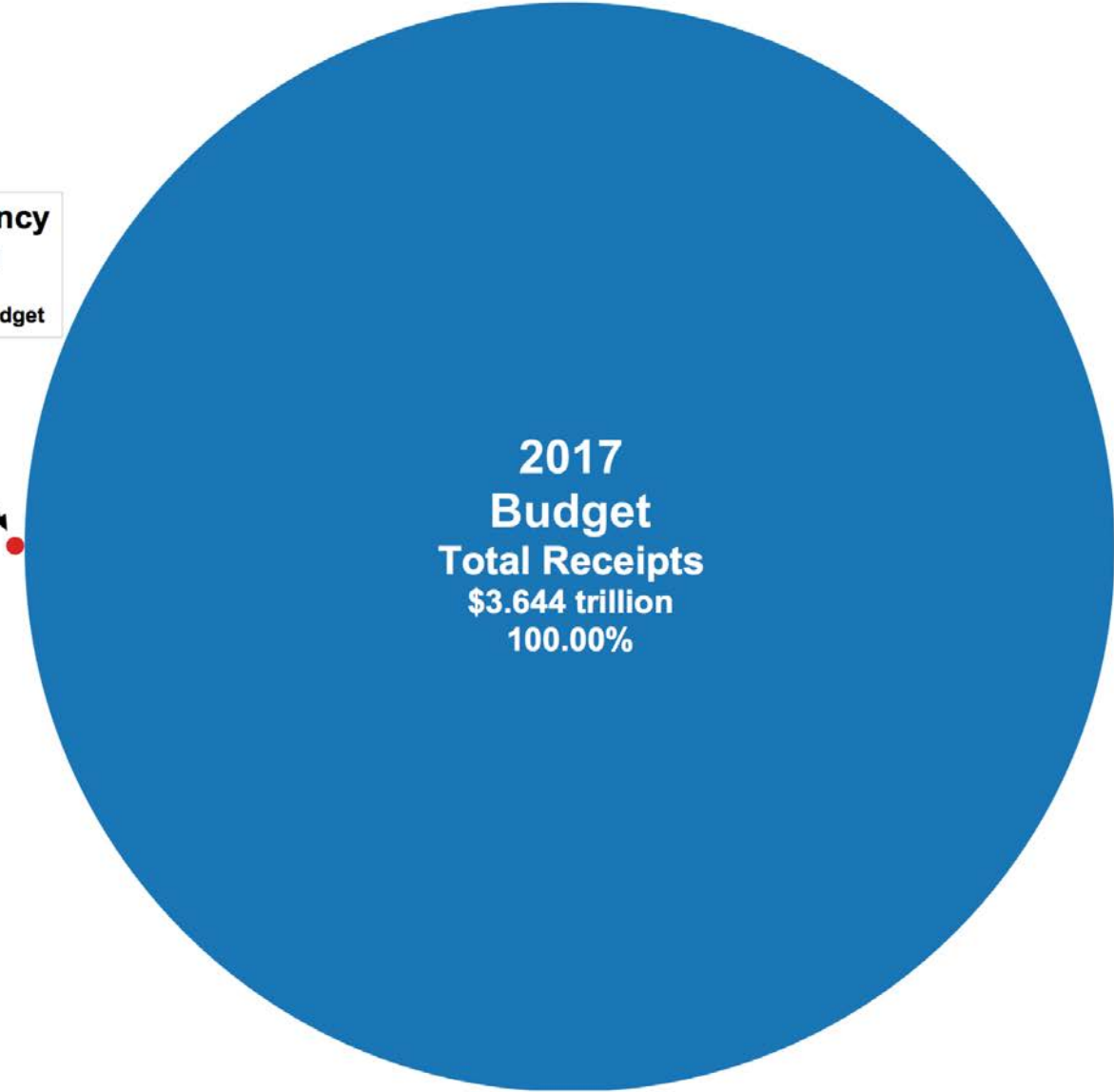
- An inconsequential error or omission is not considered a failure to include correct information. An inconsequential error or omission does not prevent or hinder the IRS from processing the Form 8971 and the Schedules A required to be filed along with it.
  - Errors and omissions that are never inconsequential are those related to a TIN, a beneficiary's surname and the value of the asset the beneficiary is receiving from the estate.
  - What if the beneficiary's TIN is unavailable?
    - Trusts that aren't funded at the time of filing that don't have an EIN
    - Foreign persons without a TIN
    - Beneficiaries that refuse to give the TIN

# Reasonable Cause Exception to Penalties

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- The penalties for failing to file a correct Form 8971 and Schedules A with the IRS and for failing to provide correct Schedules A to beneficiaries will not apply to any failure that is shown to be due to reasonable cause and not to willful neglect.
- In general, it must be shown that the failure was due to an event beyond the taxpayer's control or due to significant mitigating factors. It must also be shown that the executor or other person required to file acted in a responsible manner and took steps to avoid the failure.

**Basis Consistency**  
**\$267 million**  
.007 %  
< 1 / 10,000 of 2017 Budget



# Airplane/Ship Purchases

<b>Basis Consistency revenue (\$267m) will pay for:</b>	<b>Quantity</b>	<b>Cost Each</b>
Airbus A321	2.67	\$100m
F-22	1.78	\$150m
Boeing 767	1.34	\$200m
Kitty Hawk aircraft carrier	0.06	\$4.5b



## Alternate Way to Raise \$267m

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Taxable Returns (5,000 in 2014): Taxable Estate	\$60b
Margin Rate: increase from 40% to 40.5%	<u>0.5%</u>
Increase in annual revenue	\$300m

**Information Regarding Beneficiaries  
 Acquiring Property From a Decedent**

► Information about Form 8971 and its separate instructions is at [www.irs.gov/form8971](http://www.irs.gov/form8971).

Check box if this is a supplemental filing

**Part I Decedent and Executor Information**

<b>1</b> Decedent's name	<b>2</b> Decedent's date of death	<b>3</b> Decedent's SSN
<b>4</b> Executor's name (see instructions)	<b>5</b> Executor's phone no.	<b>6</b> Executor's TIN
<b>7</b> Executor's address (number and street including apartment or suite no.; city, town, or post office; state or province; country; and ZIP or foreign postal code)		
<b>8</b> If there are multiple executors, check here <input type="checkbox"/> and attach a statement showing the names, addresses, telephone numbers, and TINs of the additional executors.		

**9** If the estate elected alternate valuation, indicate the alternate valuation date: .....

**Part II Beneficiary Information**

How many beneficiaries received (or are expected to receive) property from the estate? ..... For each beneficiary, provide the information requested below. If more space is needed, attach a statement showing the requested information for the additional beneficiaries.

A Name of Beneficiary	B TIN	C Address, City, State, ZIP	D Date Provided

**Notice to Executors:**

Submit Form 8971 with a copy of each completed Schedule A to the IRS. To protect privacy, Form 8971 should not be provided to any beneficiary. Only Schedule A of Form 8971 should be provided to the beneficiary. Retain copies of all forms for the estate's records.

**Sign Here** Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, all information reported herein is true, correct, and complete.

<b>Sign Here</b>	Signature of executor		Date		
	May the IRS discuss this return with the preparer shown below? See instructions				Yes <input type="checkbox"/> No <input type="checkbox"/>
<b>Paid Preparer Use Only</b>	Print/Type preparer's name	Preparer's signature	Date	Check <input type="checkbox"/> if self-employed	PTIN
	Firm's name ►	Firm's EIN ►			
	Firm's address ►	Phone no.			

For Privacy Act and Paperwork Reduction Act Notice, see the separate instructions.

*BLS*



# Schedule A

## Part II Beneficiary Information

How many beneficiaries received (or are expected to receive) property from the estate? \_\_\_\_\_ For each beneficiary, provide the information requested below. If more space is needed, attach a statement showing the requested information for the additional beneficiaries.

<b>A</b> Name of Beneficiary	<b>B</b> TIN	<b>C</b> Address, City, State, ZIP	<b>D</b> Date Provided
Any errors automatically allow the Service to assess penalties.*			

### Notice to Executors:

Submit Form 8971 with a copy of each completed Schedule A to the IRS. To protect privacy, Form 8971 should not be provided to any beneficiary. Only Schedule A of Form 8971 should be provided to the beneficiary. Retain copies of all forms for the estate's records.

\*According to the instructions

# Schedule A - Continued

Form 8971 (1-2016)

## **SCHEDULE A—Information Regarding Beneficiaries Acquiring Property From a Decedent**

► Information about Form 8971 (including Schedule A) and its separate instructions is at [www.irs.gov/form8971](http://www.irs.gov/form8971).

Check box if this is a supplemental filing

### **Part 1. General Information**

<b>1</b> Decedent's name	<b>2</b> Decedent's SSN	<b>3</b> Beneficiary's name	<b>4</b> Beneficiary's TIN
<b>5</b> Executor's name			<b>6</b> Executor's phone no.
<b>7</b> Executor's address			

# Schedule A - Continued

## Part 2. Information on Property Acquired

A Item No.	B Description of property acquired from the decedent and the Schedule and item number where reported on the decedent's Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return. If the beneficiary acquired a partial interest in the property, indicate the interest acquired here.	C Did this asset increase estate tax liability? (Y/N)	D Valuation Date	E Estate Tax Value (in U.S. dollars)
1	Form 706, Schedule _____, Item _____ Description — <span style="background-color: #e0e0ff; padding: 5px;">Same as 706</span>			Same as 706

Indicate "N" for property that qualifies for the marital deduction or charitable deduction.

Date of death or alternate valuation date

Can be different for asset with non-recourse debt (i.e., \$200K 706, \$300K 8971)

# Notice to Beneficiaries

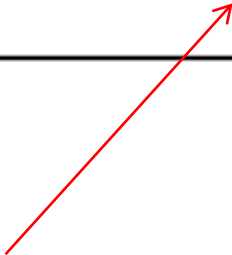
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## **Notice to Beneficiaries:**

You have received this schedule to inform you of the value of property you received from the estate of the decedent named above. **Retain this schedule for tax reporting purposes.** If the property increased the estate tax liability, Internal Revenue Code section 1014(f) applies, requiring the consistent reporting of basis information. For more information on determining basis, see IRC section 1014 and/or consult a tax professional.

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**Page A-1**



Beneficiaries should hold onto their Schedule A in order to avoid later reporting an inconsistent basis and being subject to an accuracy related penalty.

# What Assets Need to Be Listed on Schedule A?

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- In many cases, the executor does not know, within 30 days of filing Form 706, which assets will be distributed to which beneficiaries
- Some assets may be pro-rated among various beneficiaries
- Instructions to Form 8971 and Proposed regulations require that all possible assets that could go to each beneficiary must be listed on Schedule A for those beneficiaries
  - Will have to list all possible assets on Schedule A
  - Will have to list the same assets on multiple Schedule A's
  - Too much disclosure to each beneficiary may be contrary to decedent's intent
- Law would be more practical if Form 8971 were to be filed 30 days after assets were actually distributed



# Assets Excluded from Reporting Requirement (on Schedule A)

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- Cash and equivalents
  - What is definition of “equivalents”?
- Income in respect of a decedent (IRD)
  - What about Roth IRA or Employer Roth Accounts?
  - What about investment (basis) in IRA or 401k plans?
  - What about the basis in an annuity contract?
- Household goods and personal effects if appraisal is not needed under Section 20.2031-6(b)
  - Does not apply to collectibles
- Property that is sold or disposed of by the estate during the course of administration in which capital gain or loss is recognized
  - What about if gain/loss is ordinary?

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# Inconsistency Between Sections 1014(f) and 6035

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- Section 1014(f) exempts property subject to the marital and charitable deduction from the basis consistency rules
- Section 6035 does not provide the same exemption
- Form 8971 may have to be filed, with Schedule A provided to the surviving spouse



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# Inconsistency Between Sections 1014(f) and 6035 - Continued

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Example: Husband dies in 2016 after using all of his applicable exclusion amount (\$5,450,000), leaving his entire estate to his surviving spouse, subject to the marital deduction. The assets left to the surviving spouse will not be subject to the basis consistency rules since Section 1014(f) excludes assets subject to the marital deduction. However, a similar exemption does not apply under Section 6035 and since the portability election cannot be made by the executor (there is nothing left to port), the executor must file Form 8971 with the IRS and provided a copy of Schedule A to the surviving spouse.

Practice Point: Tax return preparers will need to ask clients for a copy of Schedule A to verify basis.







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# Questions