Basis Consistency and Information Reporting; New Form 8971

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TABLE OF CONTENTS

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1. Overview

The basis consistency provisions for property received from a decedent (but not the consistency proposals for gifts) were enacted as Section 2004 of the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 (the "Act"), which was signed into law July 31, 2015. This is important for planners; the legislation is effective *immediately*, and will require planners to take additional steps for all estate tax returns filed after July 31, 2015 if the estate is required to file the return.

A beneficiary's basis of property acquired from a decedent will be no higher than the finally determined estate tax values (new §1014(f)), and beneficiaries will no longer have the ability to claim that the fair market value of an asset on the date of death was actually greater than the value used for estate tax purposes. Furthermore, executors will be required to furnish information statements to the IRS and to the estate recipients about the values of estate assets (new §6035). Penalties may be imposed if the required information statements are not furnished to the IRS and to estate beneficiaries.

The IRS released Form 8971 and Instructions to Form 8971 on January 29, 2016. The Form includes a Schedule A that will be sent to each beneficiary receiving property included on the estate tax return. The initial reports under the new statutory requirement are due four weeks from that release date, by February 29, 2016. Planners have been anxiously awaiting the Form so that they may begin the process of preparing the required reports.

2. Background

For purposes of determining the basis of assets received from a decedent, the value of the property as determined for federal estate tax purposes generally is deemed to be its fair market value. Treas. Reg. §1.1014-3(a). The estate tax value is not conclusive, however, but is merely a presumptive value that may be rebutted by clear and convincing evidence except where the taxpayer is estopped by the taxpayer's previous actions or statements (such as by filing estate tax returns as the fiduciary for the estate). Rev. Rul. 54-97, 1954-1 C.B. 113; *see* Augustus v. Commissioner, 40 B.T.A. 1201 (1939). In Technical Advice Memorandum 199933001, the IRS ruled that an individual beneficiary who was not the executor of the estate and took no other inconsistent actions or statements was not estopped from trying to establish that the date of death value (and the basis) was higher than the value reported on the estate tax return.

Many beneficiaries of estates that are required to file estate tax returns, however, are now subject to a requirement that the fair market value at the date of death (or the alternate valuation date, if elected) of property acquired from the decedent, for purposes of the basis adjustment under §1014, can be no greater than the finally determined estate tax value. §1014(f). Executors must comply with elaborate reporting requirements to report those values to estate beneficiaries. §6035.

The new Form 8971, Information Regarding Beneficiaries Acquiring Property From a Decedent, will be used by executors to report the required information to the IRS. Schedule A, attached to Form 8971, is used to provide each beneficiary with information that must be reported under the new statute. There are also indications that additional guidance (which may be proposed regulations) will be issued soon, perhaps by February 5.

3. Basis Consistency and Reporting Provisions; Form 8971 and Its Instructions

a. **Section 1014(f)**.

Value Limit. Section 2004 of the Act adds new §1014(f), which provides that the basis of property to which §1014(a) applies (i.e., property acquired from a decedent) shall not exceed the final value determined for estate tax purposes (and there are detailed provisions governing when the tax is finally determined), or if the final value has not been determined, the value provided in a statement to the decedent's recipients. Observe that the "shall not exceed" wording leaves open the possibility that the IRS could take the position that the date of death value for purposes of §1041(a) is lower than the finally determined estate tax value or that legatees could claim a lower value than the estate tax value to avoid penalties if the executor overstated the value of property on the Form 706.

Exception If Property Does Not Increase Estate Taxes. This provision applies only to property "whose inclusion in the decedent's estate increased the liability for the tax imposed by chapter 11… on such estate." Observe that if there is no estate tax because of the marital or charitable deduction and therefore inclusion of the asset in the estate does not increase the liability for the estate tax imposed on such estate—because the estate tax liability "on such estate" remains at zero—the basis consistency provision of §1014(f) does not apply. Instructions to Form 8971 make clear that this exception applies to estates that have no estate tax by reason of the marital or charitable deductions in addition to estates that are below the exemption amount. Unfortunately, however, there is no similar exception in the information reporting requirements in new §6035, discussed below; all estates required to file estate tax returns will have to provide reporting information to beneficiaries even if the estate is paying no estate tax. The exception would apply to the penalty under new §6662(k), because it references §1014(f), but there is no similar exception to the penalties under §§6721 and 6722). Therefore, penalties may be imposed for failure to file the information statements required under §6035 by the due date of the tax return even though no penalties may apply for failing to file the return itself in a timely manner (because the failure to file penalty under §6651 is based on a percentage of the tax due).

b. **New §6035; Information Reporting Requirements**.

What Estates Must Report? If the estate is required to file an estate tax return under §6018(a), the executor is required to report valuation information reports to the persons described below. The Instructions to Form 8971 state that estates that file returns "for the sole purpose of making an allocation or election respecting the generation-skipping transfer tax" are not subject to reporting requirements. The Instructions do not address estates that are under the exemption amount but merely file estate tax returns to make the portability election. The information reporting requirement likely does not apply to estates that file estate tax returns merely to elect portability, but that are not otherwise required to file returns. While Treas. Reg. §20.2010-2(a)(1) provides that an estate that elects portability will be "considered" to be required to file a return under §6018(a) in addressing the timely filing requirement to elect portability, the apparent intent of this provision is to determine when a return must be filed to make the portability election, and not when a return is actually required to be filed under §6018. Hopefully, the IRS will make clear in regulations regarding §6035 that estates filing returns merely to make the portability election are not subject to the information reporting requirements of §6035. Catherine Hughes, with the Treasury Department, indicated at the recent ABA Tax Section meeting that the additional guidance expected soon will address whether a return filed merely to elect portability is subject to the reporting requirement.

Who Receives Reports? Estates that are required to file estate tax returns must give reports to both the recipients (i.e., "each person acquiring any interest in property included in the decedent's gross estate") and the IRS. §6035(a)(1). For amounts passing to trusts, must the report be given to each potential trust beneficiary or just to the trustee of the trust? There are various provisions in the Instructions to Form 8971 suggesting that the report would be given just to the trustee. For example, the Instructions state "In cases where a trust beneficiary or another estate beneficiary has multiple trustees or executors, providing Schedule A to one trustee or executor is sufficient to meet the requirement," and that the Schedule A will be delivered "to the trustee(s) of a beneficiary trust."

Presumably, the only point of providing a statement to the IRS would be to give the IRS information about assets passing to particular beneficiaries in case the IRS will track the basis information that may be reported by those beneficiaries on their future income tax returns. Giving the information to the IRS would permit the IRS to use matching programs, much like with Form 1099s, to match the basis reporting on individual beneficiaries' income tax returns when they report sales of assets received from estates. Catherine Hughes has confirmed that the IRS is revising its computer systems in light of the basis consistency statute.

When Are Reports Due? Under the statute, such statements must be furnished at the time prescribed in regulations, but no later than 30 days after the return's due date, including extensions (or 30 days after the return is filed, if earlier). §6035(a)(3)(A). The Form 8971 Instructions relax this to say that if the Form 706 is filed after the "due date," the Form 8971 and Schedule(s) A to beneficiaries are due 30 days after the "filing date" (apparently referring to the actual date the Form 706 is filed late). If valuation or other adjustments are made after the statements are furnished, supplemental statements must be furnished within 30 days of the date of the adjustment. §6035(a)(3)(B).

Extension of Due Date for Information Reports. Notice 2015-57 extended the due date for filing information reports under new §6035 to February 29, 2016. "This delay is to allow the Treasury Department and IRS to issue guidance implementing the reporting requirements of section 6035." The Notice provided that information reports should not be filed "until the issuance of forms or further guidance."

Regulatory Authority. Regulatory authority is granted to provide implementation details, including rules for situations in which no estate tax returns are required, or if the surviving joint tenant or other recipient has better information than the executor.

c. **Penalties**.

(1) *Penalties for Inconsistent Reporting*. Section 2004(c) of the Act amends §6662 to provide that the accuracy-related penalties on underpayments under §6662 apply if a taxpayer reports a higher basis than the estate tax value basis that applies under new §1014(f).

(2) *Penalties for Failure to Provide Information Returns and Statements*. Penalties for the failure to file correct "information returns" or "payee statements" are provided in §§6721 and 6722, respectively. The penalty is generally $250, with a maximum penalty for all failures during a calendar year of $3,000,000 (the maximum penalty is lower for taxpayers with average annual receipts of $5 million or less). The penalty is lowered to $50 per failure, with a maximum penalty of $500,000 per year if the information return is filed within 30 days of the due date. (These amounts are inflation adjusted.) These penalty provisions are recited in the Instructions to Form 8971 (and the Instructions provide indexed numbers for 2016); separate penalties apply to the Form 8971 to be filed with the IRS and to each Schedule A that is required to be filed with beneficiaries. The Instructions make clear that only one penalty applies for all failures relating to a single filing of a Form 8971 (even if there are multiple problems with the Form) and one penalty applies for all failures related to each Schedule A. If the failure to furnish the required information return or statement is "due to intentional disregard" of the requirement to furnish the return or statement, the statute provides for a penalty of $500.00 (inflation adjusted) or if greater, "10 percent of the aggregate amount of the items required to be reported correctly." §§6721(e) and 6722(e). ***Thus, the penalty under the statute could be quite large for intentionally disregarding the requirement to file the information returns or statements.*** Interestingly, the Instructions to Form 8971 do not refer to a possible penalty of 10% of the estate, but merely state that if the failure to file Form 8971 or a Schedule is due to intentional disregard, "the penalty is at least $530 per Form 8971 and the Schedule(s) A required to be filed along with it, with no maximum penalty."

Section 6724(a) provides a waiver of the penalties imposed by §§6721-6723 if the "failure is due to reasonable cause and not … willful neglect." The Instructions to Form 8971 provide that an inconsequential error or omission is not considered a failure to provide correct information, but errors "related to a TIN, a beneficiary's surname, and the value of the asset the beneficiary is receiving from the estate" are never considered inconsequential.

The §§6721 and 6722 penalties are extended to information returns and statements to estate recipients required under new §6035. §2004(b)(2) of the Act.

d. **Effective Date**. The amendments to §§1014(f), 6035 and 6724(d) described above "shall apply to property with respect to which an estate tax return is ***filed after*** the date of the enactment of this Act." (§2004(d) of the Act.) This applies not only to returns required after but also to any returns actually filed after the date of enactment (July 31 2015). For example, the executor may have delayed filing the estate tax return for an estate in which sufficient assets pass to the surviving spouse or charity or to a QTIP trust (the QTIP election can be made on the first return that is filed, even if it is filed late, Treas. Reg. §20.2056(b)-7(b)(4)) so that no estate tax is due for the decedent's estate.

e. **Form 8971**. Form 8971 and its Instructions were released on January 29, 2016.

- Part I of Form 8971 lists general information about the decedent and executor.
- Part II lists information about beneficiaries (including TIN, address, and the date that Schedules A are "provided" to each beneficiary).
- A Schedule A is attached to provide information to each estate beneficiary. The Schedule A includes the Form 706 Item number and description of property that the beneficiary has acquired from the decedent. For each asset listed, the executor indicates whether the asset increases estate tax liability and provides the valuation date and value. Schedule A contains a "Notice to Beneficiaries" directing the beneficiary to retain the schedule for tax reporting purposes and informing the beneficiary that if the property increased the estate tax liability, the Code requires consistent reporting of basis. [Observe: As discussed below regarding the ACTEC Comments, that notice could be confusing and even extremely misleading to some beneficiaries (for example, those receiving income in respect of a decedent). The executor may want to send the Schedule A with a letter providing more information to the beneficiary about the importance of the information reported on the Schedule A.]
- If the executor is also a beneficiary, the executor will have to send a Schedule A to himself or herself. (The Instructions say that if the executor is also a beneficiary, "the executor is a beneficiary for purposes of the Form 8971 and Schedule A.")
- The executor is directed to "[s]ubmit Form 8971 with a copy of each completed Schedule A to the IRS." The Instructions direct the executor to file the Form 8971 with all Schedules A to the IRS within 30 days after the due date (but if the return is filed late, within 30 days of the filing date) of the estate tax return. The Form 8971 and attached Schedules A are not to be filed with the Form 706, but must be filed separately. If values are adjusted, a Supplemental Form 8971 and Schedules A must be filed with the IRS within 30 days after the adjustment.
- Beneficiaries only receive Schedules A and not the Form 8971 itself. The Schedules A must be "provided" (in person or by email, U.S. mail or private delivery service) within 30 days of the due date of the estate tax return (or within 30 days of the filing date if the return is filed late). If adjustments are made to assets listed on the estate tax return (such as values or the inclusion of additional assets), an updated Supplemental Schedule A must be given to each affected beneficiary within 30 days of the adjustment.

ACTEC provided Comments to the IRS regarding the draft Form 8971 and draft Instructions on January 19, 2016. Some of the issues were addressed in the Form 8971 and Instructions that were released on January 29. Uncertainties raised by the ACTEC

Comments that were not addressed by the Form or the Instructions (and that hopefully will be addressed in regulations) include issues relating to:

- Whether reporting is required for estates below the filing limits of §6018(a) that file merely to elect portability;
- The "Notice to Beneficiaries" on the Schedule A will create substantial confusion because it says the beneficiary "received this schedule to inform you of the value of property you received from the estate …"; this will be quite confusing when all property that might be distributed to a beneficiary who has not yet been funded is listed on the Schedule A (see the discussion below regarding "Undistributed Assets"), and the Schedule A does not have a place to make clear that all of those assets are listed merely because they might be used to fund the beneficiary's bequest;
- For beneficiaries who have not been funded by the due date of the report, the Comments suggest that the Schedule A should just list the value that the beneficiary will receive, not particular assets, and that when assets included on the estate tax return are later distributed to the beneficiary, a supplemental Schedule A would list those particular assets for the beneficiary;
- Basis adjustments due to discretionary funding (for example, if an asset included on the return is distributed in satisfaction of a pecuniary bequest, thus generating gain or loss to the estate);
- Reporting requirements for cash, IRD, and the proceeds of life insurance;
- The "executor" who is responsible for the reports, particularly if there is not a court-appointed executor;
- Reporting responsibility if there are multiple executors or if there are persons in possession of property who will not give information to the executor;
- Persons entitled to reports for property subject to a trust (in particular if there are subtrusts), life estates, or a term of years interest;
- Effect of the death of a beneficiary before the beneficiary's interest is distributed from the estate;
- Reporting requirements for missing or uncooperative beneficiaries (what if the executor cannot obtain the EIN for a beneficiary, in which event the Instructions say the executor would not be entitled to relief from penalties as an "inconsequential error"?);
- Date of an "adjustment" requiring a supplemental report (for example, the date a closing agreement is signed or the date a closing letter is issued?); and
- Special considerations for community property or tangible personal property.

f. **Undistributed Assets**. A big question has been what to report 30 days after the Form 706 is filed if distributions have not been made at that time (which is typically the case). The Instructions say:

> the executor must list all items of property that could be used, in whole or in part, to fund the beneficiary's distribution on that beneficiary's Schedule A. (This means that the same property

may be reflected on more than one Schedule A.) A supplemental Form 8971 and corresponding Schedule(s) A should be filed once the distribution to each such beneficiary has been made.

Therefore, when the Form 8971 is filed 30 days after the Form 706 has been filed (and before most of the assets have been distributed), each beneficiary will receive a Schedule A reporting all items in the gross estate that "could be used" to fund the bequest to that beneficiary, "in whole or in part" (which presumably would be pretty well all of the assets in the gross estate that have not previously been distributed or sold).

This cause real heartburn for some estates. Executors may be reluctant to provide full information about all estate assets to beneficiaries who are only entitled to receive a general bequest that may represent a fairly small portion of the estate. Furthermore, it will be burdensome. In effect, *each* beneficiary who has not already been funded by the 30 day due date will receive a report that may be about as long as the Form 706–including a list of all assets listed on the return that have not yet been sold or distributed and that could be distributed to the beneficiary.

When distributions are later made, a revised Schedule A will be sent to the beneficiary and a supplemental Form 8971 will be sent to the IRS. The Instructions do not provide a due date for when the Supplemental Form 8971 is due to the IRS or when the updated supplemental Schedules A are due to affected beneficiaries. (This is important because penalties apply if reports are not filed or "provided" timely.)

g. **Practical Administration and Fairness Issues**. This provision can lead to unfair results because the beneficiary may have had no input in the estate tax audit negotiations, and the executor may have "traded off" on the valuation of various assets. With this provision, the executor will have to consider the effect of audit negotiations on the basis of assets received by the various individual beneficiaries. Furthermore, the executor will have to consider the values that are reported on the Form 706 with respect to the impact upon beneficiaries for basis purposes.

Regulations will need to provide many implementation details. For example, must information statements be provided to beneficiaries receiving specific cash bequests (there's no exception in the Instructions)?

Must the information be provided for income in respect of a decedent items or for appreciated property acquired by the decedent by gift within one year of death that is left to the donor? Those items receive no basis step-up at death; they are exceptions from §1014(a) [see §1014(c) and §1014(e)] so the basis consistency provisions do not apply to those items. Information reporting about the estate tax values of those items would at best be useless and may actually create confusion for beneficiaries (leading them to believe they may be able to use the estate tax value as the basis). (The Form 8971 has no exception for income in respect of a decedent assets or assets subject to §1014(e).)

There is no discussion of what to do for property that is sold by an estate and reinvested and the reinvested proceeds are later distributed to a beneficiary (which also occurs frequently as estates liquidate or diversify to minimize the risk of loss before estate taxes are paid). Presumably they would not be listed on the Schedule A (which makes sense because the estate will have recognized a gain or loss when the assets were sold and the beneficiary's basis will no longer be determined under §1014).

h. **Revenue Impact; "Cracking Nuts With a Sledgehammer."** Furthermore, one wonders if the revenue raised (the Joint Committee on Taxation estimates a $1.542 billion revenue impact between 2015 and 2025) will be less than the additional expense that will be incurred by estates in complying with the information reporting measures within 30 days after estate tax returns are filed. For large estates having various beneficiaries who cannot be funded by the due date of the reports, imagine the volume of reports that will be required when issuing "mini-Form 706's" to each beneficiary. Most planners believe the revenue estimate is wildly overblown; one planner has referred to this basis consistency and reporting concept as "cracking nuts with a sledgehammer."