BESSEMER TRUST

Legislation Requiring Consistency of Basis with Estate Tax Value and Requiring Information Reporting

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Table of Contents

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1. Overview

One of the recurring estate planning-related items in the President's Budget Proposals over the last seven years has been enacted into law. 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 (and is not merely filing to elect portability).

Beneficiaries will be required to use the finally determined estate tax values as the basis of property acquired from a decedent under §1014 (new §1014(f)), and 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.

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. In Janis v. Commissioner, T.C. Memo 2004-117, *aff'd*, 461 F.3d 1080 (9th Cir. 2006) the court applied a duty of consistency where the sole beneficiaries were also the sole co-executors of the estate, The court held that the discounted estate tax value of an art gallery set the basis of individual art works (proportionately), observing that the beneficiaries were not contending that the discounted value was incorrect for estate tax purposes. A duty of consistency was also applied in Van Alen v. Commissioner, T.C. Memo 2013-235, to estop beneficiaries who had signed an agreement consenting to the special use valuation election; the beneficiaries were estopped from arguing that the basis was higher than the special use value.

The President's Budget proposal for fiscal year 2010, published on May 11, 2009 proposed various "loophole closers" to help fund a reserve for health care reform, including a consistency of basis provision. It proposed that gift transferees would be required to use the donor's basis, (except that the basis in the hands of the recipient can be no greater than the value of the property for gift tax purposes). The basis of property received by death of an individual would be the value for estate tax purposes. Regulations would address implementation details, such as rules for situations in which no estate or gift tax return is required, when recipients may have better information than the executor, and when adjustments are made to the reported value after the filing of an estate or gift tax return.

The "Description of Revenue Provisions Contained in the President's Fiscal Year 2010 Budget Proposal" issued by the Staff of the Joint Committee on Taxation on September 8, 2009 provided further insight. As to the estoppel issue, the report stated that a beneficiary "should not be estopped from claiming a basis different from the value determined by an executor for estate tax purposes where the taxpayer did not participate in the executor's determination." In addition, the report took the position that the basis would be the value "*reported* for transfer tax purposes" (i.e., the value placed on the gift or estate tax return) and not the value ultimately determined in an estate or gift tax audit. The report said that would have "the salutary effect of encouraging a more realistic value determination in the first instance." The report added that the salutary effect would be lost if there were a relief mechanism in case the basis used by transferees differed from the fair market value "ultimately determined for transfer tax purposes." In contrast, the Greenbook said that the basis would be "the value of that property for estate tax purposes" and that regulations would address "the timing of the required reporting in the event of adjustments to the reported value subsequent to the filing of an estate or gift tax return.") Finally, the report clarified that under the proposal, the basis of the recipient can be no *greater than* the value determined for estate and gift tax purposes, but the recipient could claim a lower value to avoid accuracy-related penalties under §6662 if the transferor overstated the value for transfer tax purposes.

This proposal was repeated in the Administration's Revenue Proposals for Fiscal Years 2011-2016 but the Proposals made clear that the value as finally determined for estate tax purposes would apply, not just the reported value. A legislative proposal of that approach was contained in section 6 of the Responsible Estate Tax Act in 2010 (S. 3533 and H.R. 5764), in the December 2010 "Baucus Bill, and in section 5 of "The Sensible Estate Tax Act of 2011" legislative proposal (H.R. 3467).

3. Basis Consistency Provisions in Legislation Extending Highway Trust Fund

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, which extends funding of the "Highway Trust Fund" through October 29, 2015 and which was signed into law July 31, 2015 (the "Act").

a. ***New Section 1014(f)***. 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. 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) apparently does not apply. There is no similar exception, however, in the information reporting requirements in new §6035, discussed immediately below. 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. ***Information Reporting Requirements****.* If the estate is required to file an estate tax return under §6018(a), the executor is required to report valuation information 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). [Observe that the information reporting requirement 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) for purposes of the timely filing requirement to elect portability, that provision only applies for purposes of determining when a return must be filed to make the portability election, and not when a return is actually required to be filed under §6018. Also observe that the broad description of the recipients who are entitled to receive information may indicate that the information must be provided to all current and potential future trust beneficiaries for assets in revocable trusts or for estate assets that pass to trusts.] 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). 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). 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 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).

d. ***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 ($100 for returns or statements required before 2016), with a maximum penalty for all failures during a calendar year of $3,000,000 ($1,500,000 for returns or statements required before 2016). 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 penalty is $500 ($250 for returns or statements required before 2016) 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 can be quite large for intentionally disregarding the requirement to file the information returns or statements.***

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." (Section 6723 imposes a smaller penalty for the failure to comply with "a specified information reporting requirement," but that section does not apply. The regulations to §6723 provide that the section applies only to certain specifically listed information requirements, none of which is the information required under new §6035. Treas. Reg. §301.6723-1.)

The §§6721 and 6722 penalties are extended to information returns and statements to estate recipients required under new §6035. Section 2004(b)(2) of the Act revises the definitions of "information return" and "payee statements" (as those terms are used in §§6721 and 6722) to include statements to be filed with the IRS as "information returns" and statements to be provided to estate recipients as "payee statements," by amendments to §6724(d). (Those definitions apply "for purposes of this part" (which refers to Part I of Subchapter B of Chapter 68—including §§6721 and 6722).)

e. ***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." (Section 2004(d) of the Act.) This means that the information returns and recipient statements (and penalties for failure to furnish such statements) apply for returns actually filed after July 31, 2015, even for decedents who died before July 31, 2015.

   For decedents who died long enough ago that the due date for filing the estate return has already passed, the Act literally says that the information return and recipient statements were due on the due date of the return—even though that was before the Act was even passed, in effect imposing a retroactive due date. In addition, penalties are applicable (retroactively, in effect, if the due date for the return has already passed). This potential retroactive application of the Act may apply in various situations. 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. Hopefully, relief will be provided by the IRS for those "retroactive due date" situations. In particular, it would seem that the 10% penalty for intentional disregard of the requirement of filing the information returns and recipient statements under §§6721(e) and 6722(e) would not apply when the requirement to make such information returns and statements was not even known on the date that the Act now says they were due. Similarly, the $250 per occurrence penalty for failure to furnish required information statements should be waived under the §6724(a) reasonable cause exception in those retroactive due date situations.

f. ***Practical Administration and Fairness Issues***. Carol Harrington pointed out several years ago that this provision is unfair 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.

   In many estates, the executor will not know 30 days after the estate tax return is filed what assets will be passing to particular estate beneficiaries. In that case, the executor may need to provide the valuation information to every estate beneficiary about all estate assets except for beneficiaries receiving only specific bequest s of particular property. 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.

One wonders why there is a necessity of providing a statement to the IRS about values of assets reported on an estate tax return when the estate tax return itself has already been filed with the IRS. 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. The identification of particular assets passing the particular beneficiaries will not be available, however, for many estates by 30 days after the estate tax return is filed (and obviously before an estate tax closing letter is received).

Regulations will need to provide many implementation details and will be very important in making the statutory requirements administrable. For example, must information statements be provided to beneficiaries receiving specific cash bequests? Must the information statement be provided to a beneficiary who is also the executor? What information must be provided to beneficiaries if the executor does not know what specific assets will be distributed to beneficiaries by the time the information statements are due? What information must be supplied to the IRS that is not in the estate tax return itself?

Furthermore, one wonders if the revenue raised will come close to 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.