BESSEMER TRUST

The Statute of Limitations and Disclosure Rules for Gifts

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Table of Contents

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1. Background

a. Section 2504(c):

(1) Original version in the Internal Revenue Code of 1954:

> (c) Valuation of certain gifts for preceding calendar years. If the time has expired within which a tax may be assessed under this chapter or under corresponding provisions of prior laws, on the transfer of property by gift made during a preceding calendar year, as defined in section 2502(c), and if a tax under this chapter or under corresponding provisions of prior laws has been assessed or paid for such preceding calendar year, the value of such gift made in such preceding calendar year shall, for purposes of computing the tax under this chapter for the calendar year 1955 and subsequent calendar years, be the value of such gift which was used in computing the tax for the last preceding calendar year, for which a tax under this chapter or under corresponding provisions of prior law was assessed or paid.

(2) The Ways and Means Committee explained:

> Due to the cumulative nature of the gift tax and the progression in gift tax rates, the tax liability for gifts in a particular year is dependent on the correct valuation of gifts in prior years.…
>
> It is believed that once the value of a gift has been accepted for the purposes of the tax by both the Government and the taxpayer, this value should be acceptable to both in measuring the tax to be applied to subsequent gifts. For that reason the bill provides that the value of a gift as reported on a taxable gift tax return for a prior year is to be conclusive as to the value of the gift (after the statute of limitations has run) in determining the tax rate to be applied to subsequent gifts. This substantially increases certainty in the gift tax area.

H.R. Rep. No. 1337, 83d Cong., 2d Sess. 93-94 (1954).

(3) Until 1997, the amendments of section 2504(c) were of a technical nature only.

(a) Introduction of quarterly gift tax returns in section 102(a)(4) of the Excise, Estate and Gift Tax Adjustment Act of 1970 (Public Law 91-614).

(b) Return to annual gift tax returns in section 442(a)(4)(C) of the Economic Recovery Tax Act of 1981 (Public Law 97-34).

(4) Prior to 1977, it was common to take advantage of section 2504(c) by paying at least a nominal amount of gift tax. The Internal Revenue Service accommodated this technique by recognizing that use of the $30,000 lifetime gift tax specific exemption was optional and could be spread over as many gift tax returns as the donor chose. Reg. §25.2521-1(a); Rev. Rul. 79-160, 1979-1 C.B. 313.

(5) On the other hand, the Service took the position in regulations that the rule of section 2504(c) "does not apply to adjustments involving issues other than valuation." Reg. §25.2504-2 (before its amendment in 1999).

(a) This position was actually invited by the 1954 legislative history: "This subsection … will not prevent adjustment where issues other than valuation of property are involved." H.R. REP. NO. 1337, 83D CONG., 2D SESS. A322 (1954); S. REP. NO. 1622, 83D CONG., 2D SESS. 479 (1954).

(b) Case law also gave some support to this position. *See Daanen v. Commissioner,* T.C. Memo. 1971-69 (1971) (Reg. §25.2504-2 cited with approval, although it appears that issue in the case was only the value of a **future** gift, not the calculation of the gift tax).

b. "Unification" of the Gift and Estate Taxes in the Tax Reform Act of 1976

(1) While the gift tax had historically been cumulative from year to year, at rates equal to three-fourths of the estate tax rates, the Tax Reform Act of 1976 (Public Law 94-455) partially "unified" the gift and estate taxes by making the estate tax cumulative with the gift tax through the concepts of "adjusted taxable gifts" (section 2001(b)(1)(B)) and a "unified credit" (sections 2505 & 2010), with the same stated rates. The Act repealed the former specific exemptions of $30,000 for gift tax purposes (section 2521) and $60,000 for estate tax purposes (section 2052).

(2) The Ways and Means Committee commented:

> The amount of estate tax is to be determined by applying the unified rate schedule to the aggregate of cumulative lifetime and deathtime transfers and then subtracting (or "offsetting") the gift taxes payable on the lifetime transfers. As a transitional rule, the completed lifetime transfers taken into account in determining cumulative transfers at death for purposes of imposing the estate tax are only to include taxable gifts made after December 31, 1976. Correspondingly, the gift tax paid with respect to gifts made before January 1, 1977, is not to be included as part of the subtraction or offset in computing the estate tax. The subtraction, or offset, is to include the aggregate amount of gift tax payable on gifts made after December 31, 1976.
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> Transfers included in the tax base as lifetime transfers (described as "adjusted taxable gifts" by the bill) are not to include transfers which are also included in the decedent's gross estate (i.e., transfers made within three years of the date of death and lifetime transfers where the decedent had retained certain interests, rights or powers in the property). This is to preclude having the same lifetime transfers taken into account more than once for transfer tax purposes. The gift tax payable on these transfers is to be subtracted in determining the estate tax imposed.

H.R. Rep. No. 94-1380, 94th Cong., 2d Sess. 13 (1976)

(3) The Tax Reform Act of 1976 amended section 2504(a) to preserve the operation of the repealed specific exemption (now in section 2504(a)(3)), but did not amend section 2504(c).

c. The Treatment of Section 2504(c) in the "Unified" Regime

(1) In Rev. Rul. 79-398, 1979-2 C.B. 338, citing differences in the statutory language between the new section 2505 and the former section 2521, the Service ruled that the use of the unified credit against gift tax was mandatory, unlike the use of the gift tax exemption of prior law.

(2) In Technical Advice Memorandum 8132011 (April 24, 1981), stating that "[t]he impact of the rule of 2504(c) on the unified credit has raised many questions from taxpayers and District Officers," the Service rejected the taxpayer's argument that the use of the unified credit, in effect, constitutes the assessment or payment of gift tax and ruled that section 2504(c) does not apply until gift tax is paid because the unified credit has been exhausted. *See also* General Counsel Memorandum 38703 (April 28, 1981); Technical Advice Memorandum 8447005 (July 26, 1984).

(3) The Service formalized this interpretation in Rev. Rul. 84-11, 1984-1 C.B. 201.

(4) *Boatmen's First National Bank of Kansas City v. United States,* 705 F. Supp. 1407 (W.D. Mo. 1988), held that gifts could not be revalued in the calculation of adjusted taxable gifts for estate tax purposes. The court seemed to be influenced by the taxpayer's argument that if adjusted taxable gifts were adjusted (on line 4 of the estate tax return) without adjusting the amount of gift tax attributable to those gifts (on line 7 of the estate tax return), this would be tantamount to taxing the gifts (via the estate tax) after the gift tax statute of limitations had run. Correspondingly, the court saw no way it could adjust the gift tax on line 7, because the gift tax statute of limitations foreclosed recalculation of the gift tax. The court also noted that "an indefinite limitations period would place an undue burden of proof upon the taxpayer who made a gift many years prior to death, thinking that the value was established finally upon the expiration of the three-year period." The court did the only thing it thought it could do – it forbade the adjustment of the value of the gift on line 4.

(5) On June 13, 1990, in a 10-8 decision, the Tax Court refused to apply section 2504(c) to the estate tax. *Estate of Smith v. Commissioner,* 94 T.C. 872 (1990) (reviewed by the Court), *acq.,* 1990-2 C.B. 1. Judge Tannenwald, writing for the majority, reasoned:

> We recognize that in *Boatmen's First Nat. Bank of Kansas City v. United States,* 705 F. Supp. 1407 (W.D. Mo. 1988), the District Court concluded that section 2504(c) should be read into the estate tax by relying on what it perceived was the legislative intent of unification and the practical problems that would arise for taxpayers if respondent is permitted to revalue prior taxable gifts. Although the facts and arguments made in *Boatmen's* are similar to those before us, we respectfully disagree with that court's decision.
>
> We are aware that taxpayers may face practical problems in attempting to prove value for estate tax purposes many years after a gift was given. These problems have been forcefully articulated by many commentators who have called for legislative correction. See 20 Real Prop., Prob. and Trust J. [1113], at

1120 [Winter 1985]; Tax Section Recommendation No. 1980-5, Committee on Estate and Gift Taxes, 33 Tax Lawyer 1531, 1533-1536 (1980); R. Stephens, G. Maxfield and S. Lind, Federal Estate and Gift Taxation, sec. 2.01[2] at 2-4 (1983); Covey, Recent Developments Concerning Estate, Gift and Income Taxation, 12 Institute on Estate Planning, sec. 105.1 at 1-77 (1978). In this connection, we note that, even in the context of section 2504(c), such practical problems still remain, albeit in a narrow frame of reference, because that section is not operative if a gift tax has not been "assessed or paid." We also note that the need to contend with such problems is a one-time event where the estate tax is concerned in contrast with recurring and possibly numerous events in respect of the gift tax where gifts are made in each of several years.

In sum, however much we might agree that the presence of an estate tax counterpart of section 2504(c) would be highly desirable, courts:

> are not authorized to rewrite a statute because they might deem its effect susceptible of improvement. See *TVA v. Hill,* 437 U.S. 153, 194-195 *** (1978). This is especially so when courts construe a statute of limitations, which "must receive a strict construction in favor of the Government." *E. I. du Pont de Nemours & Co. v. Davis,* 264 U.S., at 462 ***. [*Badaracco v. Commissioner,* 464 U.S. at 398.]

We hold that, in computing "adjustable taxable gifts" under section 2001(b)(1)(B), respondent may re-examine and adjust prior taxable gifts to reflect the value of such gifts as of the date of the gifts.

94 T.C. at 877-78.

(6) In the second branch of its opinion, however, the Tax Court did what the district court in *Boatmen's* felt it could not do. Faced with only halfhearted resistance from the Service, it required the adjustment of the gift tax subtraction on line 7 of the estate tax return to match the amount of gift tax that "would have been payable" (as section 2001(b)(2) says) if the prior gifts had been valued as redetermined in the consideration of the estate tax return. Id. at 878-80. Therefore, the result sought and secured by the Service in *Smith* is significant only when the valuation adjustment pushes the estate into a higher estate tax bracket. For gifts and estates of such magnitude that they are in the top bracket anyway, the *Smith* rule probably matters very little.

(7) Just five months later, in announcing its recommendation of acquiescence in the second branch of the *Smith* decision, the Chief Counsel's office stated:

> Section 2504(c) provides that gifts made in preceding periods cannot be revalued for purposes of computing the gift tax after a gift tax has been assessed or paid and the statute of limitations for assessment of gift tax has expired. In the instant case, the Tax Court held that section 2504(c) is limited solely to gift taxes. See also *Ward v. Commissioner,* 87 T.C. 78, 113-14, n.12 (1986). Therefore, the Service may reexamine and adjust prior taxable gifts to reflect the value of such gifts as of the date of the gifts in computing adjusted taxable gifts for purposes of section 2001(b)(1)(B).
>
> The Tax Court further determined that the calculation of the subtraction for gift taxes under section 2001(b)(2) is not limited to the amount of gift taxes actually paid. Rather, the subtraction for gift taxes must be adjusted to take into account any increase in the values of previous gifts. *Estate of Smith,* slip op. at 12. This determination is supported by both the statutory language and the legislative history. The Service agrees with the Tax Court's rationale and holding on this issue.

Action on Decision 1990-032 (Nov. 13, 1990).

(8) The approach of Smith was followed in *Evanson v. United States,* 30 F.3d 960 (8th Cir. 1994); *Estate of O'Neal v. United States,* 84 AFTR 2d ¶ 99-7088 (N.D. Ala. 1999); *Stalcup v. United States,* 792 F. Supp. 714 (W.D. Okla. 1991); *Estate of Lenheim v. Commissioner,* T.C. Memo. 1990-403. *See also Levin v. Commissioner,* 986 F.2d 91 (4th Cir.), cert. denied, 510 U.S. 816 (1993).

d. Contemporaneous Pressures on Valuation

(1) Most estate planners with four or five decades of experience have war stories of the good old days when valuation issues were settled quickly and informally – sometimes literally on the "back of an envelope" and frequently for some percentage of book value which by today's standards would seem low.

(2) Ascendant valuation strategies, especially fractionalization "discount" strategies, as well as increasingly aggressive resistance from the Service, have largely put an end to those opportunities.

2. The Taxpayer Relief Act of 1997

a. Following continued expressions of dissatisfaction on the part of commentators and practitioners with the first result in *Smith,* Congress in the Taxpayer Relief Act of 1997 (TRA '97) (Public Law 105-34, enacted August 5, 1997) added a new section 2001(f) to overrule *Smith* and deny revaluation for estate tax purposes of all gifts adequately disclosed on a gift tax return once the gift tax statute of limitations has run.

b. The Act also amended section 2504(c) to drop the requirement that a current gift tax must have been paid to achieve this finality of valuation, thus extending the finality of valuation provided by that statute to gifts that merely use some or all of the donor's unified credit. Following a technical amendment in 1998, section 2504(c) now reads:

> (c) Valuation of gifts.—If the time has expired under section 6501 within which a tax may be assessed under this chapter 12 (or under corresponding provisions of prior laws) on—
>
> (1) the transfer of property by gift made during a preceding calendar period (as defined in section 2502(b)); or
>
> (2) an increase in taxable gifts required under section 2701(d),
>
> the value thereof shall, for purposes of computing the tax under this chapter, be the value as finally determined (within the meaning of section 2001(f)(2)) for purposes of this chapter.

c. In the final piece of its trilogy of relief provisions, TRA '97 added section 7477 to the Code to empower the Tax Court to issue declaratory judgments regarding the value of gifts, including use of the unified credit, if the donor has first exhausted the available administrative remedies with the Service.

(1) Proposed regulations, relating to the availability of declaratory judgments regarding the value of gifts under section 7477, were published on June 9, 2008 (REG-143716-07), and final regulations, Reg. §301.7477-1, were published on September 9, 2009, and effective September 9, 2009.

(2) The regulations describe a "notice of preliminary determination of value" (Letter 950-G, similar to a "30-day letter") to be used in such cases, which the donor may use as the basis for a formal protest to request consideration by Appeals, and a "notice of determination of value" (Letter 3569, similar to a statutory notice of deficiency or "90-day letter"), which empowers a donor to file a petition with the Tax Court.

(3) The regulations acknowledge that exhaustion of administrative remedies is ultimately a matter to be determined by the Tax Court, but that the Service will view full participation in the Appeals process, including a post-petition referral to Appeals if a Letter 950-G is not issued for reasons other than the donor's delay or the donor's timely request for Appeals consideration is not granted, as an administrative remedy that the statute requires to be exhausted. Reg. §301.7477-1(d)(4)(i)-(iv). The Service will not assert that the refusal to extend the statute of limitations is a failure to exhaust administrative remedies. Reg. §301.7477-1(d)(4)(v).

(4) The preamble to the proposed regulations included a moderately interesting philosophical discussion about the relationship between these procedures and the gift tax disclosure rules of section 6501(c)(9), including a discussion of the Service's discretion to examine a transfer and place it in controversy currently even though it considers the transfer not to have been adequately disclosed for purposes of section 6501(c)(9). *See* Reg. §301.7477-1(e), Example 5.

d. The repose and relief provisions of section 2001(f), amended section 2504(c), and section 7477 are effective for gifts made after August 5, 1997, the date of enactment of TRA '97.

(1) By making a rule affecting the calculation of **the estate tax** applicable with reference to the date of **gifts,** Congress is saying that all gifts **on or before August 5, 1997,** can still be revalued in the

calculation of the estate tax on the donor's estate. That seems at first blush to clash with the apparent repose objective of the statute.

(2) On the other hand, it could be argued that this is the correct rule, because the Service has not previously been on notice that it will not have an opportunity to scrutinize gift tax returns at the donor's death.

e. Congress coupled these welcome changes with an expansion of the "unlimited statute of limitations" (admittedly a linguistic monstrosity!) of section 6501(c)(9) to all gifts. (Section 6501(c)(9) had originally been added to the Code in 1990 to require disclosure in a gift tax return of transactions subject to the valuation rules of sections 2701 and 2702, under penalty of permitting an assessment of gift tax with respect to such transactions at any time, even if a gift tax return was filed for the year of the transaction.) After a technical amendment in 1998, section 6501(c)(9) now reads:

> (9) Gift tax on certain gifts not shown on return.—If any gift of property the value of which (or any increase in taxable gifts required under section 2701(d) which) is required to be shown on a return of tax imposed by chapter 12 (without regard to section 2503(b)), and [*sic*] is not shown on such return, any tax imposed by chapter 12 on such gift may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time. The preceding sentence shall not apply to any item which is disclosed in such return, or in a statement attached to the return, in a manner adequate to apprise the Secretary of the nature of such item.

The paragraph is not grammatical. The clause beginning "If" (of which "gift" is the subject) has no verb. The paragraph would be grammatical if the comma and the word "and" in the fifth line were deleted. Then "is not shown" would be the verb to go with the subject "gift."

f. The Ways and Means Committee explained:

> The bill provides that a gift for which the limitations period has passed cannot be revalued for purposes of determining the applicable estate tax bracket and available unified credit. For gifts made in calendar years after the date of enactment, the bill also extends the special rule governing gifts valued under Chapter 14 to all gifts. Thus, the statute of limitations will not run on an inadequately disclosed transfer in calendar years after the date of enactment, regardless of whether a gift tax return was filed for other transfers in that same year.
>
> It is intended that, in order to revalue a gift that has been adequately disclosed on a gift tax return, the IRS must issue a final notice of redetermination of value (a "final notice") within the statute of limitations applicable to the gift for gift tax purposes (generally, three years). This rule is applicable even where the value of the gift as shown on the return does not result in any gift tax being owed (e.g., through use of the unified credit). It is also anticipated that the IRS will develop an administrative appeals process whereby a taxpayer can challenge a redetermination of value by the IRS prior to issuance of a final notice.
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> A taxpayer who is mailed a final notice may challenge the redetermined value of the gift (as contained in the final notice) by filing a motion for a declaratory judgment with the Tax Court. The motion must be filed on or before 90 days from the date that the final notice was mailed. The statute of limitations is tolled during the pendency of the Tax Court proceeding.

H.R. Rep. No. 105-148, 105th Cong., 1st Sess. 359-60 (1997).

g. As for the generation-skipping transfer (GST) tax, section 2661(1) provides that, except for generation-skipping transfers occurring at the same time as and as a result of an individual's death, the provisions of subtitle F (which includes section 6501) applicable to the gift tax apply also to the GST tax.

h. The amendment to section 6501(c)(9) is effective for gifts made after December 31, 1996. Thus, increased disclosure is required for all gifts reported on a 1997 gift tax return, even though the enhanced repose conferred by TRA '97 is available only for gifts made after August 5, 1997. That means that whatever contemporaneous record-keeping or other action might be appropriate to facilitate compliance with the disclosure requirement should have already been in place since the first of the year in which Congress acted.

3. Comments on the Taxpayer Relief Act of 1997

a. The greatest significance of the "relief" provisions of TRA '97 is that they will help persons with middle-sized estates, who cannot afford to make gifts of such magnitude that they are in the top bracket where the *Smith* rule does not affect them, and who cannot necessarily even afford to make gifts that use up their unified credits and generate some current tax. *Cf.* Rev. Rul. 79-398, *supra;* Rul. 84-11, *supra.* Such a person will now be able to make a moderate-sized gift and know that three years after filing a gift tax return reporting that gift the Service will not be able to revalue the gift for purposes of computing the tax on future gifts or the tax on that person's estate. If the gift does not use all of the donor's unified credit, the credit which the donor assumes will be available for future transfers really will be. If the Service disagrees with that, it must say so currently – *i.e.,* within three years – and the donor can appeal such a determination to the Tax Court even if no gift tax deficiency is actually assessed.

b. The expansion of section 6501(c)(9), however, is a tremendously significant departure from long-settled policies of repose in the administration of the tax system. Under this rule, the Service appears to be free at any time to impose gift tax (with interest and possibly penalties) on the most insignificant or dubious gift that is inadvertently or for good cause omitted from a gift tax return. The enactment of section 6501(c)(9) in 1990, applicable to transactions covered by sections 2701 and 2702, was not nearly as controversial, because such transactions would normally be entered into intentionally and with plenty of professional advice.

c. The IRS has noted that section 6501(c)(9) does not extend the period for assessment when an understatement of gift tax on a return results solely from a non-fraudulent, non-willful underreporting of the amount of taxable gifts in prior years, stating that "[i]t would take a legislative fix to § 6501(c)(9) and (e)(2) to close this gap." Chief Counsel Advice 201614036 (March 10, 2016).

4. Promulgation of Regulations

a. On December 21, 1998, the Internal Revenue Service released proposed regulations to implement the changes made by TRA '97.

b. The Service received comments from the public and, in April 1999, held a public hearing on those proposed regulations.

c. On November 18, 1999, the Treasury Department promulgated the regulations in final form, applicable to gifts made after December 31, 1996, for which the gift tax return is filed after December 3, 1999.

d. When compared to the proposed regulations, the final regulations go a long way in providing assurances that minor foot-faults in documenting value will not result in lack of repose, that a good faith disclosure effort should be respected, and that the hindsight of a zealous gift tax examiner decades later will not be superimposed as the disclosure standard.

5. Two Disclosure Safe Harbors

a. The most significant improvement in the final regulations is to provide safe harbors for disclosures, setting out steps which, if followed, will ensure that the disclosure has been adequate and that the statute of limitations applies.

(1) The proposed regulations had provided that a gift would be considered adequately disclosed "only if" (but not "if") certain information were included in the return. In other words, the proposed regulations set forth disclosures that would be **required** for the statute of limitations to apply, but not disclosures that would be considered **sufficient** for that purpose.

(2) The final regulations continue to require that a gift be reported on a gift tax return "in a manner adequate to apprise the Internal Revenue Service of the nature of the gift and the basis for the value so reported." Reg. §301.6501(c)-1(f)(2).

(3) The final regulations go on, however, to provide that a transfer "**will** be considered adequately disclosed" if certain information about the transfer is provided and either an appraisal is provided that contains certain prescribed elements or certain information is provided about the method of valuation. *Id.* These available options may be regarded as an "Appraisal Safe Harbor" and a "Description Safe Harbor."

b. While the 1997 version of section 6501(c)(9) replaced the 1990 version (applicable to gifts valued under section 2701 or 2702 and deemed gifts under section 2701(d)), the regulations under the 1990 version (Reg. §301.6501(c)-1(e)) continue to apply in an "only if" way to such transfers. Those transfers are explicitly exempted from the "safe harbor" approach of the regulations by Reg. §301.6501(c)-1(f)(1).

6. Information Common to Both Safe Harbors

a. Both safe harbors require the submission of basic information describing the transaction:

(1) A description of the transferred property. Reg. §301.6501(c)-1(f)(2)(i).

(2) A description of any consideration received by the transferor of the property. *Id.*

(3) The identity of the transferor and transferee and the relationship between them. Reg. §301.6501(c)-1(f)(2)(ii).

(4) For a gift in trust, the trust's taxpayer identification number and either a copy of the trust instrument or "a brief description of the trust terms." Reg. §301.6501(c)-1(f)(2)(iii).

(a) The option of simply attaching a copy of the trust instrument is new in the final regulations.

(b) The proposed regulations would have required "a brief description of the terms of the trust," which caused considerable concern about how to make such a description both "brief" and adequate.

b. The regulations require the identification of "any position taken that is contrary to any proposed, temporary or final Treasury regulations or revenue rulings published at the time of the transfer." Reg. §301.6501(c)-1(f)(2)(v).

(1) This requirement to identify positions contrary to regulations and revenue rulings will be irksome to some, but it is hard to say it is unreasonable. In any event, it is a vast improvement over the proposed regulations, which would have also required "a statement of the relevant facts affecting the gift tax treatment of the transfer that reasonably may be expected to apprise the Internal Revenue Service of the nature of any potential controversy concerning the gift tax treatment of the transfer, or in lieu of this statement, a concise description of the legal issue presented by the facts." Proposed Reg. §301.6501(c)-1(f)(2)(vi), 63 FED. REG. 70701, 70706 (Dec. 22, 1998).

(2) Moreover, there generally are not many pertinent regulations or revenue rulings that a gift tax return would ordinarily defy.

(3) For example, an employee who undertakes to make a gift of a nonstatutory stock option before it is vested should presumably disclose that this position is contrary to Rev. Rul. 98-21, 1998-1 C.B. 975.

(4) Care will now have to be taken to check **proposed** regulations, which sometimes have been forgotten.

7. Appraisal Safe Harbor

a. The Appraisal Safe Harbor is satisfied if, in addition to the above information, the donor submits an appraisal by an individual who holds himself or herself out to the public as an appraiser or who regularly performs appraisals, who is qualified by background, experience, education, and professional memberships (if any) to appraise the type of property involved, and who is not the transferor or transferee or a member of the family of the transferor or transferee or a person employed by any such individual. Reg. §301.6501(c)-1(f)(3)(i).

(1) For this purpose, the "family" of any individual includes the persons listed in section 2032A(e)(2) – the individual's ancestors, spouse, descendants of parents, descendants of spouse, and the spouses of any such descendants.

(2) It is reasonable to assume that "person employed" means a regular employee and does not mean, for example, that the transferor cannot "employ" – that is, engage – the appraiser. That is not clear from the regulations, but such a limitation would not make any sense. The Service reportedly will apply a facts-and-circumstances test, so that, for example, an accounting firm might be considered "employed" if 90 percent of its revenue comes from a family business it is engaged to value.

b. The submitted appraisal must contain the following information:

(1) A description of the appraiser's qualifications, as set forth above. Reg. §301.6501(c)-1(f)(3)(i)(B).

(2) The date of the transfer and the date the property was appraised. Reg. §301.6501(c)-1(f)(3)(ii)(A).

(a) It is not clear from the regulations that it is enough for the appraisal to state an "as of" date, or if the appraiser must actually refer to that date as "the date of the transfer." While there does not appear to be any purpose served by insisting on such strict compliance with the regulations, prudence suggests that the precise words be used where possible.

(b) There is no question that this will put a strain on the customary practice of planning several similar transfers around the date of a single appraisal, such as annual exclusion gifts both at the end of December and at the beginning of January and gifts following the closing of books at the end of a fiscal year.

(3) The purpose of the appraisal. *Id.*

(a) The usual recital of a purpose "to determine the fair market value of the property for gift tax purposes" should be sufficient.

(b) While a reference to "gift tax value" might be viewed as potentially arousing suspicion by implying that "gift tax value" is different from "fair market value," the adequacy of a disclosure for gift tax statute of limitations purposes should be enhanced by the acknowledgment that the appraisal was procured and done "for gift tax purposes."

(4) A description of the property. Reg. §301.6501(c)-1(f)(3)(ii)(B).

(5) A description of the appraisal process employed. Reg. §301.6501(c)-1(f)(3)(ii)(C).

(6) A description of the assumptions, hypothetical conditions, and any limiting conditions and restrictions on the transferred property that affect the appraiser's analyses, opinions, and conclusions. Reg. §301.6501(c)-1(f)(3)(ii)(D).

(7) The information considered in determining the appraised value. Reg. §301.6501(c)-1(f)(3)(ii)(E).

(a) In the case of "an ownership interest in a business," the regulations provide that the appraisal should include "all financial data that was used in determining the value of the interest that is sufficiently detailed so that another person can replicate the process and arrive at the appraised value." This is again a substantial improvement over the proposed regulations, which **required** (again, not merely as an element of a safe harbor) the submission of "any relevant financial data," thus, in the view of some, exposing donors to contentions long after the fact that arguably "relevant" financial details were omitted. (After all, questions about the meaning of these regulations will by their nature only arise more than three years after the gift tax return is filed, when the statute of limitations would otherwise bar assessment of gift tax.) By limiting the financial data required under the Appraisal Safe Harbor to the data that was actually **used** by the appraiser, the final regulations provide a reasonably objective test that will be much harder to second-guess later.

(b) Obviously, the specific use of financial data by a business appraiser is often affected by the appraiser's judgment. Therefore, it would be unreasonable to expect the mere provision of the data used by the appraiser to permit another appraiser to "replicate the process" and come up with the same value, and it would be unreasonable to expect the regulations to be interpreted to require that.

(c) If the Appraisal Safe Harbor is to be relied on, however, every judgment that affects the appraiser's use of financial data should be made explicit in the appraisal.

(d) Another, perhaps unexpected, result of the way the final regulations are worded is that if a donor intends to invoke the "business" purpose of an entity (such as a family limited partnership) and also rely on the Appraisal Safe Harbor for gift tax repose, then it would be only prudent for the appraisal to include the financial data required by the regulations in the case of an ownership interest in a "business."

(8) The appraisal procedures followed, and the reasoning that supports the appraiser's analyses, opinions, and conclusions. Reg. §301.6501(c)-1(f)(3)(ii)(F).

(9) The valuation method utilized, the rationale for that valuation method, and the procedure used in determining the fair market value. Reg. §301.6501(c)-1(f)(3)(ii)(G).

(10) The specific basis for the valuation. Reg. §301.6501(c)-1(f)(3)(ii)(H). (The regulations give as examples "specific comparable sales or transactions, sales of similar interests, asset-based approaches, merger-acquisition transactions, etc.")

c. Although these appraisal requirements overlap somewhat and the technical use of appraisal terms is open to some criticism, the regulations generally recite elements that should be included in any well prepared appraisal. This cannot be taken for granted, however, and one clear lesson of these regulations is that appraisals expected to be submitted with gift tax returns should be carefully reviewed to make sure that they include all these items.

8. Description Safe Harbor

a. The Description Safe Harbor is satisfied if, in addition to the required information common to both safe harbors, the donor submits with the gift tax return a detailed description of the method used to determine the fair market value of the transferred property. Reg. §301.6501(c)-1(f)(2)(iv). An appraisal is not needed, which will make the Description Safe Harbor especially attractive for relatively small transfers, such as annual-exclusion gifts, where the technique might be to simply apply the analysis of a recent appraisal to current financial data.

b. The description must include the following information. *Id.*

(1) The financial data used in valuing the transferred property, such as balance sheets, with explanations of any adjustments.

(2) Any restrictions on the transferred property that were considered.

(3) A description of any discounts claimed, such as discounts for blockage, minority or fractional interests, and lack of marketability.

(4) For a gift of an interest in an entity such as a corporation or partnership that is not actively traded, a description of any discounts claimed in valuing any assets owned by the entity (as well as any discounts claimed in valuing the transferred interest itself – a requirement that is stated twice in the same subdivision of the regulations).

(5) For a transfer of an interest in an entity properly valued with reference to the value of the assets held by the entity, a statement regarding the undiscounted fair market value of 100 percent of the entity, the pro rata portion of the entity subject to the transfer, and the fair market value of the transferred property as reported on the return.

(a) This requirement is limited to cases where "the value of the entity or of the interests in the entity is properly determined based on the net value of the assets held by the entity." Although it misses the point a bit by treating asset-based valuation and valuation based on a pro rata share of the entire entity value as interchangeable, this limitation is an effort to be helpful, and generally it is. It is not clear whether this requirement applies any time the value of the interest **could** "properly" be based on the value of 100 percent of the entity, or whether it applies only when the appraiser **actually uses** the value of 100 percent of the entity in determining the value of the interest and that use is "proper." The latter interpretation would be most consistent with the general tone of the regulations, but the regulations at this point do not seem to be written with the possibility in mind that there often are two or more ways to value property, including an interest in an entity.

(b) More troubling, however, is the follow-up statement in the regulations that "[i]f 100 percent of the value of the entity is not disclosed, the taxpayer bears the burden of demonstrating that the fair market value of the entity is properly determined by a method other than a method based on the net value of the assets held by the entity." *Id.*

i. This is probably not the law, despite the regulations, because case law under the comparable six-year statute of limitations of section 6501(e) makes it clear that after three years the **Government** has the burden of proving both that the disclosure was inadequate and that a gift was made. *Cf. Estate of Dillingham v. Commissioner,* 903 F.2d 760, 762 (10th Cir. 1990), *aff'g* 88 T.C. 1569 (1987); *Peters v. Commissioner,* 51 T.C. 226, 230 (1968); *Reis v. Commissioner,* 1 T.C. 9, 12-14 (1942) (vacated and modified after the Commissioner introduced evidence), *aff'd,* 142 F.2d 900 (6th Cir. 1944). There is no reason for the result to be different under the even harsher "unlimited" statute of limitations, and the failure of the otherwise quite responsive final regulations to acknowledge that is a mystery.

ii. Of course, in gift and estate tax cases in general, the Government has the burden of proof under section 7491, if the taxpayer meets the substantiation, record-keeping, and cooperation requirements of section 7491(a)(2). (By its terms, section 7491(a)(2)(C), which incorporates the net worth tests of 28 U.S.C. §2412, via section 7430(c)(4)(A)(ii), applies only to partnerships, corporations, and trusts, not individuals and estates.)

iii. For a welcome admission that the IRS has the burden of proving inadequate disclosure, see Part 12.e(5) below.

iv. For an example of the burden of proof in the context of summary judgment, see *Estate of Sanders v. Commissioner,* T.C. Memo. 2014-100, discussed in 14.b below.

(6) For a transfer of an interest in a non-actively-traded entity that itself directly or indirectly owns an interest in another non-actively-traded entity, a detailed description of the method used to determine the fair market value of that owned interest, including all the foregoing information, if the information is "relevant and material" in determining the value of the interest. Reg. §301.6501(c)-1(f)(2)(iv).

(a) In the case of the transfer of an interest that is actively traded on an established exchange, a recitation of the exchange, the CUSIP number, and the mean between the highest and lowest quoted selling prices on the applicable valuation date will be deemed to satisfy the requirement of "a detailed description of the method used." *Id.* It will not be necessary for every gift tax return to include a treatise on the history, operation, and regulation of such exchanges!

(b) It is not clear from the regulations or even from the preamble whether the "relevant and material" standard for providing detailed information on a lower-tier entity applies to the valuation of the interest in that lower-tier entity or to the valuation of the interest that is the subject of the transfer. For example, if a donor makes a gift of a fractional interest in a limited liability company *(A),* which in turn is a partner in a limited partnership *(B),* it is not clear whether detailed information about *B* that is arguably relevant and material to the valuation of an interest in *B* is needed if the value of *A's* interest in *B* is not relevant and material to the valuation of the transferred interest in *A.* The context of the discussion in the preamble to the regulations suggests, however, that the information must be provided only if it is relevant and material in the valuation of the *A* interest that was transferred. That would be a sensible result. Even so, the apparent requirement to provide financial information about indirectly owned entity interests, and even directly owned entity interests, where the donor does not control the entity, will continue to be one of the most troublesome burdens on the donor who wishes to rely on the Description Safe Harbor.

(c) The requirement that the statement attached to the return include "the fair market value of the transferred property as reported on the return" (as well as the double recitation of the requirement to describe entity interest discounts) is a quixotic confirmation of the fascination and frustration with valuation discounts that formed so much of the backdrop against which the regulations were drafted. Of course "the fair market value of the transferred property as reported on the return" will be reported on the return. The grammatical structure of the regulations, however, suggests that this requirement is viewed as a necessary element of "a detailed description of the method used to determine the fair market value of property transferred." Therefore, it might be prudent to take the requirement literally and make sure that both the hypothetical undiscounted value of the entire entity and the fair market value (properly discounted) of the transferred interest are juxtaposed in a single document attached to the return.

9. Split Gifts

a. The final regulations provide, helpfully, that if a married couple elect to treat a gift by one of them as a gift made one-half by each of them, only the donor spouse needs to comply with the disclosure requirements. Reg. §301.6501(c)-1(f)(6).

b. But if each spouse makes gifts, each must comply with the disclosure requirements, even if the gifts are of the same type.

10. Non-Gifts

a. The regulations expressly permit the disclosure of a transfer or other transaction that is not viewed as a gift, to start the statute of limitations on any assertion by the Service that that transfer or other transaction had a gift element. Reg. §301.6501(c)-1(f)(4).

(1) This is true even though there is otherwise no reason to file a gift tax return. Reg. §301.6501(c)-1(f)(7), *Example 2.*

(2) Examples might include a gift that qualifies for the annual exclusion (*id.*), a possible gift portion of a transaction structured as a sale, and a gift that is incomplete because of a retained power or interest (Reg. §301.6501(c)-1(f)(5)).

b. Under Reg. §301.6501(c)-1(f)(4), the prescribed manner of disclosure includes:

(1) A description of the transferred property. Reg. §§301.6501(c)-1(f)(4)(i) & -1(f)(2)(i).

(2) A description of any consideration received by the transferor of the property. *Id.*

(3) The identity of the transferor and transferee and the relationship between them. Reg. §§301.6501(c)-1(f)(4)(i) & -1(f)(2)(ii).

(4) For a gift in trust, the trust's taxpayer identification number and either a copy of the trust instrument or "a brief description of the trust terms." Reg. §§301.6501(c)-1(f)(4)(i) & -1(f)(2)(iii).

(5) Identification of "any position taken that is contrary to any proposed, temporary or final Treasury regulations or revenue rulings published at the time of the transfer." Reg. §§301.6501(c)-1(f)(4)(i) & -1(f)(2)(v).

(6) An explanation as to why the transfer is not a gift. Reg. §301.6501(c)-1(f)(4)(ii).

c. Reg. §301.6501(c)-1(f)(4) backslides into an "only if" formulation, reminiscent of the proposed regulations. Thus, notwithstanding the recital of the preamble that "the final regulations limit the information required in a non-gift transaction" in response to a commentator's criticism "that the standard for adequate disclosure [in the proposed regulations] is higher for a 'non-gift' than it is for a gift transaction," it appears that the final regulations are still vulnerable to the same criticism.

d. The regulations provide an exception from disclosure on a gift tax return for "[c]ompleted transfers to members of the transferor's family, as defined in section 2032A(e)(2), that are made in the ordinary course of operating a business …, provided the transfer is properly reported by all parties for income tax purposes." Reg. §301.6501(c)-1(f)(4).

(1) The regulations give only the example of compensation paid to a family member. *Id.*

(2) Presumably the payment of rent, royalties, and interest is also exempt, if it is in the ordinary course of business.

(3) The regulations provide no answer to the natural question of whether the exception applies to transactions in the ordinary course of business that other-wise require no current reporting for income tax purposes – *i.e.,* when the "proper" reporting for a transaction is no reporting at all. This could result in some unusual tactics to trigger an income tax reporting requirement, such as a section 83(b) election within 30 days of receipt of a stock option or similar restricted property, or structuring a split-dollar life insurance plan to produce some amount of taxable income. Or perhaps the regulations contemplate statements of non-income on income tax returns, analogous to the reporting of non-gifts on gift tax returns!

(4) Curiously, by limiting this exception to family members, the regulations arguably impose a higher burden for gift tax purposes on transfers outside of the family.

(5) Members of a transferor's family under section 2032A(e)(2) mean the transferor's ancestors, the transferor's spouse, the descendants (by blood or adoption) of the transferor or of the transferor's spouse or of the parents of either, and the spouses of any such descendants.

(6) In any event, this exception does not apply to transactions not in the ordinary course of business, such as a transfer of an interest in the business.

(7) This exception was cited, but not really analyzed, in *Estate of Brown v. Commissioner,* T.C. Memo. 2013-50. See Part 14.a(6) below.

11. Late Disclosure

a. Disclosure required to start the gift tax statute of limitations must be made "on a gift tax return … or in a statement attached to the return." Reg. §301.6501(c)-1(f)(1); *cf.* section 6501(c)(9). This presents the dilemma of how to remedy a shortcoming in the disclosure that accompanied the original return, when the law does not specifically provide for amended gift tax returns. Ironically, taxpayers who do not file a timely return at all do not face this dilemma, because they can simply file a late return and include adequate disclosure with it.

b. Fulfilling a commitment in the Treasury-IRS 2000 Priority Guidance Plan to provide "guidance under section 2501 relating to late adequate disclosure," Rev. Proc. 2000-34, 2000-2 C.B. 186, solved this dilemma.

(1) Beginning August 22, 2000, the disclosure requirements may be met by filing an amended gift tax return with the following caption at the top of the first page: "Amended Form 709 for gift(s) made in [insert the calendar year that the gift was made] - In accordance with Rev. Proc. 2000-34, 2000-2 C.B. 186." Rev. Proc. 2000-34, section 4. The amended return, which must be filed in the same Service Center as the original return, must identify the transfer in question (which presumably can be by a reference to the appropriate item in the original return), but otherwise need only provide what the original return lacked.

(2) The Service accepted other submissions filed before August 22, 2000, if they contained sufficient information to comprise adequate disclosure under the regulations. No resubmissions to conform to Rev. Proc. 2000-34 were required. Rev. Proc. 2000-34, section 5.

(3) The statute of limitations begins running from the date of filing of the amended return (or other pre-August 22, 2000 submission) including adequate disclosure. Rev. Proc. 2000-34, section 2. Because there is no due date for a late disclosure, it is unlikely that the postmark rule of section

7502 applies, but the only effect of that is to extend the statute a few days. A return receipt should be requested for all such filings.

(4) Rev. Proc. 2000-34, section 3, provides that these amended return procedures do not apply to fraudulent returns, to willful attempts to evade tax, or to cases of failure to file a return. In the context of explaining how to file an amended return, the reference to failure to file a return is odd, unless it means (improbably) that labeling a first return an "amended" return under this procedure is a fatal defect.

(5) With the Service's exam resources stretched thin, it is hard to say how thoroughly **any** gift tax returns, included amended returns, will be scrutinized, but it should not be assumed that an amended return will get **less** scrutiny. Therefore, it will usually be a good idea to try to achieve adequate disclosure with the original return.

12. Substantial Compliance

a. The preamble to the final regulations states that the Service considered the suggestion that the final regulations include a "substantial compliance" or "good-faith effort" exception, but rejected that suggestion "in view of the difficulty in defining and illustrating what would constitute substantial compliance."

(1) The preamble helpfully continues, however, to state that "it is not intended that the absence of any particular item or items would necessarily preclude satisfaction of the regulatory requirements, depending on the nature of the item omitted and the overall adequacy of the information provided."

(2) This expectation is reinforced by the structure of the final regulations in providing a single generic requirement and more detailed safe harbors. If the requirements of one of the safe harbors were "substantially," but not strictly, satisfied, the taxpayer would presumably have an argument that the disclosure was nevertheless "adequate to apprise the Internal Revenue Service of the nature of the gift and the basis for the value so reported" under the general rule. Reg. §301.6501(c)-1(f)(2). Thus, a specific acknowledgment of "substantial compliance" is not as crucial in the "if," rather than "only if," approach of the final regulations.

b. The analogous six-year statute of limitations under section 6501(e)(2) if the amount of omitted gifts exceeds 25 percent of the amount of gifts stated on the return does not apply to any item "disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the [Service] of the nature and amount of such item."

(1) The case law has been colorful.

(a) In 1958, the Supreme Court wrote: "We think that in enacting § 275(c) [the predecessor of section 6501 in the Internal Revenue Code of 1939] Congress manifested no broader purpose than to give the Commissioner an additional two [now three] years to investigate tax returns in cases where, because of a taxpayer's omission to report some taxable item, the Commissioner is at a special disadvantage in detecting errors. In such instances the return on its face provides **no clue** to the existence of the omitted item." *The Colony, Inc. v. Commissioner,* 357 U.S. 28, 36 (1958) (emphasis added). *See also University Country Club, Inc. v. Commissioner,* 64 T.C. 460, 469-70 (1975).

(b) In 1970, Judge Tannenwald elaborated on this theme of a "clue": "The touchstone in cases of this type is whether respondent has been furnished with a 'clue' to the existence of the error.… Concededly, this does not mean simply a 'clue' which would be sufficient to intrigue a Sherlock Holmes. But neither does it mean a detailed revelation of each and every underlying fact." *George Edward Quick Trust v. Commissioner,* 54 T.C. 1336, 1347 (1970), *aff'd per curiam,* 444 F.2d 90 (8th Cir. 1971).

(c) *See also Estate of Williamson v. Commissioner,* T.C. Memo. 1996-426, in which the court found that the income tax rules of section 6501(e)(1) and the estate and gift tax rules of section 6501(e)(2) are "in pari materia" for this purpose (thus validating the authority of the income tax precedents in estate and gift tax cases).

(2) Obviously, under section 6501(c)(9), it may be relevant that there are specific extensive regulations. The question is what significance those regulations have, when they are devoted largely to the description of "safe harbors."

c. For a number of years, Chief Counsel Advice 200221010 (issued Feb. 12, 2002; released May 24, 2002) appeared to be the only comprehensive treatment of this issue by the Service. This document is so significant that it is reproduced in full in the Appendix to this outline.

(1) Although this document addressed a gift that had been made before the published effective date of the regulations and Rev. Proc. 2000-34, it concluded that "the principles upon which [the regulations and Rev. Proc. 2000-34] are based are implicit in section 6501(c)(9) itself." Applying those principles, the Chief Counsel's office found inadequate the disclosure of a gift expressed as: "Class B Units in ABC LLC. Units acquired on 4/6/97 for $200,000 cash." Citing Reg. §25.6019-4, the Chief Counsel's office concluded that adequate disclosure in that case required at least disclosure of "the number of units in the limited liability company, the class type, and the percentage of ownership interest that the gift represents." Since the disclosure in that case did refer to "Class B Units," the reference to "the class type" presumably requires a description of the features of that class of interest – *i.e.,* voting or nonvoting, distribution and liquidation preferences, convertibility rights, and the like.

(2) The issue addressed in this document was not academic. The donor had reported the gift on the gift tax return at a value of $200,000, while the Service believed (after the regular three-year statute had run) that it should have been valued at $14,000,000!

(3) Careful reading of Chief Counsel Advice 200221010 reveals that the gift tax return in question was filed on October 9, 1998, and therefore the regular three-year statute of limitations expired no earlier than October 9, 2001. But the introduction to the Chief Counsel Advice indicates that it was written in response to the addressee's "memorandum dated November 7, 2001." It seems very unlikely that **in less than a month between October 9, 2001, and November 7, 2001,** the IRS examiners discovered the return, spotted the valuation issue, determined that a proper value would have been 70 times what the donor had reported, and wrote a memorandum about it. The much more likely explanation is that the IRS had already been seriously examining this return and this valuation issue for some time before the three-year statute ran. Yet the Chief Counsel Advice does not acknowledge that the gift at issue had been "disclosed in such return, or in a statement attached to the return, in a manner adequate to apprise the Secretary of the nature of such item" – that is, in a manner adequate to prompt the examiners to do exactly what they were doing – which is the standard in section 6501(c)(9) quoted in the Chief Counsel Advice itself. Indeed, the Chief Counsel Advice explicitly concludes that the information provided on the return "did not allow the Commissioner to make a reasonably informed decision whether to select the return for audit," even though the return was already under audit and had obviously been selected for audit long before the three-year statute ran. The natural inference is that the examiners let the statutory period expire without obtaining an extension or issuing a notice of deficiency, and the Chief Counsel Advice provides not an analysis of the statute and regulations that should be persuasive to a court, but simply cover for a colleague's mistake.

d. Without much analysis, Chief Counsel Advice 201024059 (May 11, 2010) concluded that the gift tax may be assessed at any time under section 6501(c)(9) where "a donor of stock of a closely-held business failed to disclose on the gift tax return: (1) any information with respect to the method used to determine the FMV of the stock; and (2) any description of discounts used to value the stock when discounts were in fact used to value the stock."

e. Legal Advice Issued by Field Attorneys (LAFA) 20152201F, issued by the Associate Area Counsel (SB/SE) in Jacksonville, Florida, on March 13, 2015, addressed the adequacy of disclosure of gifts of interests in two family limited partnerships that owned real estate and had an S corporation as the common general partner.

(1) Apparently to allow time for an IRS valuation engineer to complete the IRS's own appraisal, the IRS estate and gift tax attorney had asked that the gift tax statute of limitations be extended for two years and two months. The donor's attorney responded in an email as follows:

> Appraisals were done specifically for the gifting. You have been sent the … appraisals of real estate, the partnership agreements and you have the … appraisals of the partnership minority discount/lack of marketability/etc for … those partnerships involved in the gifting. Therefore I believe you have the … information to show that the form 709 was properly done. Therefore the … estate will not be signing to extend the statute for a 2 year 2 month period.

(2) According to the LAFA, the names of the partnerships were abbreviated on the gift tax return, the employer identification number of one partnership was missing a digit, and the appraisals attached to the return valued the land held by each partnership but not the partnership interests themselves.

(3) Applying the description safe harbor of Reg. §301.6501(c)-1(f)(2), LAFA 20152201F stated in part:

ANALYSIS

…

The complete EIN for … permits the Service to determine the full name of that partnership, but the partial EIN for … does not. Once the … partnership is identified by querying its EIN, it is possible to extrapolate that the … partnership may also have been abbreviated and from there to discover that the EIN provided matches that unabbreviated partnership's EIN once the missing "…" is inserted after the dash. [And in a footnote: "Excluding any check digits in an EIN, the missing digit could be any integer between 0 and 9 and in any of the seven positions after the dash. That results in seventy possible EINs that the partial EIN could match. It is not reasonable to expect the Service to look up seventy EINs to find the one that matches the … partnership, particularly because even when the correct EIN is identified, it matches the … unabbreviated partnership, rather than the partnership actually described by Donor."] Donor's … gift tax return and the statement attached to that return may have described the … partnership, but he failed to adequately describe the … partnership. The Code requires a disclosure adequate to apprise the Secretary of the nature of the gift, I.R.C. § 6501(c)(9), but the abbreviated name and botched EIN failed to do so for the … partnership interests.

…

This valuation description does not include "a detailed description of the method used to determine the fair market value of the property transferred, including any financial data ... utilized in determining the value of the interests." § 301.6501-1(f)(2)(iv). This description recites that Donor had the land appraised, not that he had the partnership or the donated partnership interest appraised. The description does not identify "any restrictions on the transferred property that were considered in determining the fair market value". Id.

This description further suggests (by asserting that the assets are primarily farm land and that the land was appraised) that … and … are properly valued based upon … the net value of their assets. Id. If that is the case, the return's valuation description is not "detailed" as required by the regulation. There is no financial data (e.g., actual land values) used in determining the value of the gifts. Id. There is no explanation of the method (e.g., comparable sales) used to determine the value nor any explanation of either how the … % discount breaks down between different discount types or the basis for the discounts taken. The "etc" in the return's description suggests that unlisted discounts were applied to the gifts. Id. There is also no statement regarding the 100 percent value of either … or …, even though both entities appear to be valued based upon their net assets.

…

CONCLUSION

The assessment statute of limitations exception in I.R.C. § 6501(c)(9) applies to Donor's … Form 709. That return fails to adequately disclose Donor's transfer of interests in … and …. In particular, the return failed to sufficiently identify the … partnership and failed to sufficiently describe the method and information used to determine the fair market value of the gifts. The Service may assess gift tax based upon those transfers at any time.

(4) Significantly, LAFA 20152201F makes no effort to analyze the requirements of the statute apart from the **safe harbor** of Reg. §301.6501(c)-1(f)(2) and appears to view analysis under the safe harbor as the equivalent of analysis of the "adequate" requirement in **the statute** itself. Also, apparently like the return considered in Chief Counsel Advice 200221010, the return considered in the LAFA was under audit before the three-year statute ran.

(5) LAFA 20152201F does admit, however, that "if the Service issues a notice after April 15, … [presumably the three-year statute of limitations date], it will bear the burden of proving that an exception to the … three-year statute of limitations applies. *See Harlan v. Commissioner,* 116 T.C. 31, 39 (2001) (citing *Reis v. Commissioner,* 142 F.2d 900 (6th Cir. 1944), *aff'g* 1 T.C. 9 (1942))." This confirms the discussion of the burden of proof in Part 8.b(5)(b) above.

f. Then came Legal Advice Issued by Field Attorneys (LAFA) 20172801F, also issued by the Associate Area Counsel (SB/SE) in Jacksonville, Florida, on May 10, 2017.

(1) The recital of facts was very thin:

> Donor made gifts in Years 1, 2, 3, 4, 5, and 6, but did not file Forms 709 for those years. Donor also made gifts in Year 7, and filed a Form 709 for that year. On the Year 7 Form 709, Donor did not describe any of the property transferred in Year 7, nor did Donor provide a description of the method used to determine the value of that property.

(2) Not surprisingly, the LAFA held that the statute of limitations had not run on the returns for either Years 1 through 6 or Year 7.

(3) What is surprising is that the LAFA adds: "Under Rev. Proc. 2000-34, 200-2 C.B. 186, Donor may commence the running of the statute of limitations by filing complete and accurate Forms 709 for Years 1-7." Of course, Rev. Proc. 2000-34 explicitly states (emphasis added):

> This revenue procedure applies where the donor **filed** a federal gift tax return (Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return) for the appropriate calendar year but failed to adequately disclose a gift because the gift was not reported on the return or because the information required under section 301.6501(c)-1(f)(2) for the gift was not submitted with the return. This revenue procedure **does not apply** in any situation where section 6501(c)(1), (c)(2), or **(c)(3)** [no return filed] applies.

Thus, while certainly the failure to file returns for Years 1 through 6 could be corrected by simply filing initial returns, Rev. Proc. 2000-34 could not possibly apply where no returns were filed.

g. The implication in most of these IRS documents, however, is that the drafters view the safe harbors in the disclosure regulations as if they were substantive requirements. This may have little practical significance, because taxpayers would be prudent to fall within the safe harbors if possible. But, like the improper invocation of Rev. Proc. 2000-34 in LAFA 20172801F, it raises concerns about the rigor of the Service's analysis.

h. The "qualified appraisal" requirement applicable to certain charitable contributions for income tax purposes, under Reg. §1.170A-13(c), is arguably a more stringent standard than these gift tax disclosure rules, because such qualified appraisals are part of the substantive requirements to qualify for a deduction. Nevertheless, case law has recognized a "substantial compliance" doctrine in the context of such qualified appraisals. *Bond v. Commissioner,* 100 T.C. 32 (1993). *But see Hewitt v. Commissioner,* 109 T.C. 258 (1997), *aff'd per curiam,* 1998 WL 802042 (4th Cir. Nov. 19, 1998) ("substantial compliance" doctrine does not apply when there has been practically no compliance).

13. Scope of Repose

a. The proposed regulations, following the example of the then-current version of Reg. §25.2504-2, provided that the repose rules of sections 2001(f) and 2504(c) would not apply to adjustments involving issues other than valuation. These repose rules do not mean much in large estates that are already in the top tax bracket, because the second holding in *Smith* allows the taxpayer to increase the gift tax subtracted under section 2001(b)(2) any time the Service increases adjusted taxable gifts under section 2001(b)(1)(B). But it was still viewed as unfair that the repose was not coextensive with the required disclosure. It was also viewed as inappropriate that this approach to repose could hurt middle-sized estates more than the largest estates.

b. Thus, it was welcome news when the final regulations extended the repose of sections 2001(f) and 2504(c) to all issues. Reg. §§20.2001-1(b) & 25.2504-2(b).

14. Case Law

a. In *Estate of Brown v. Commissioner,* T.C. Memo. 2013-50, the Tax Court denied the executor's motion for summary judgment with respect to whether the IRS was barred by the statute of limitations from assessing and collecting any gift tax with respect to transactions that were in the form of a sale and a capital contribution, respectively.

(1) On January 1, 2004, the decedent, as trustee of a marital trust, transferred interests in a limited liability company to two other trusts in exchange for promissory notes. On January 4, 2004, as trustee of her living trust, she made gifts of interests in the same LLC to two other trusts. She reported the January 4 gifts on her 2004 gift tax return. She did not report the January 1 transfers on her gift tax return, but she reported them as related-party installment sales on the marital trust's 2004 federal income return.

(2) On or about December 1, 2006, as trustee of the living trust, the decedent transferred $2,500,000 to a partnership that owned a mobile home park, in exchange for a 25-percent interest in the partnership. She did not file a 2006 gift tax return. (She died on December 7, 2007, and that 25-percent partnership interest was reported on her estate tax return as having no value.)

(3) On August 25, 2011, the IRS issued a notice of deficiency of gift taxes, asserting, among other things, gift tax with respect to the decedent's January 1, 2004, and December 1, 2006, transfers, and corresponding increases in taxable gifts in preceding periods with respect to her 2007 gifts, in the amounts of $758,448, $1,150,000, and $720, respectively.

(4) In the Tax Court, the decedent's executor moved for "summary judgment in petitioner's favor with respect to the following issues: (1) Is respondent barred by the applicable statute of limitations from assessing and collecting any gift tax of decedent that is attributable to the January 1, 2004 transfers and the December 1, 2006 transfer (statute of limitations issue)? (2) Did decedent make any taxable gifts during her taxable year 2004 (other than the gifts that she reported in the 2004 gift tax return that she filed) and her taxable year 2006 (gift tax issue)?" The executor maintained that there was no genuine dispute of material fact in resolving those issues and that the estate was entitled as a matter of law to summary adjudication on those issues. The executor argued that the January 1, 2004, and December 1, 2006, transfers did not result in gifts.

(5) Citing *Sundstrand Corp. v. Commissioner,* 98 T.C. 518, 520 (1992), *aff'd,* 17 F.3d 965 (7th Cir. 1994), the Tax Court noted that the party moving for summary judgment bears the burden of proving that there is no genuine dispute of material fact, and that factual inferences are viewed in the light most favorable to the nonmoving party. On the record, the court found that there were genuine disputes of material fact, including the respective fair market values exchanged on January 1, 2004, and December 1, 2006, and the ordinary-course-of-business and arm's-length character of those transfers for gift tax purposes. Accordingly, the court denied the executor's motion for summary judgment.

(6) The court cited section 6501(c)(9) and also cited the exception in Reg. §301.6501(c)-1(f)(4) for transfers to members of the transferor's family in the ordinary course of operating a business that are properly reported for income tax purposes. (See Part 10.d above.) But there was no significant discussion of the adequate disclosure standards as such.

(7) On January 6, 2014, pursuant to the agreement of the parties, the Tax Court issued a stipulated decision finding deficiencies in gift tax due for 2004 and 2007 in the amounts of $480,735 and $10,800, respectively, and finding no deficiency or overpayment of gift tax for 2006. That is a little over one-fourth of the amounts the 2011 notice of deficiency had asserted.

b. In *Estate of Sanders v. Commissioner,* T.C. Memo. 2014-100, the Tax Court denied the executor's motion for summary judgment with respect to whether gifts were adequately disclosed so as to trigger the running of the limitations period for assessment of additional gift tax.

(1) Decedent's husband founded a farm supply company that became a large business in the Mid-South. Decedent owned stock in the company and made gifts of the company stock to family members each year from 1999 through 2008. Each year, Decedent filed gift tax returns and reported the gifts. Decedent died in 2008. The IRS examined the gift tax returns and, in 2012, issued deficiency notices for federal gift tax for nine of the ten years at issue, and increased the value of the adjusted taxable gifts reported by the estate by $3,248,613 by reason of those gifts.

(2) The estate filed a motion for partial summary judgment to challenge the IRS's attempt to increase the value of the gifts reported on the gift tax returns on the ground that the statute of limitations had run.

(3) As in *Brown,* the court noted that it will grant summary judgment only if it is shown that there is no genuine dispute as to any material fact and that it may render a decision as a matter of law. In this case, the estate had the burden of proving that there was no genuine dispute as to any material fact with the facts being reviewed in the light most favorable to the IRS. The court found that there were genuine disputes between the estate and the IRS with respect to whether the gift tax returns adequately disclosed the nature of the stock and the basis of the value reported. The IRS had also contended that the information provided on the gift tax returns failed to disclose the company's ownership of another closely-held entity, which the regulations require if that information is relevant and material in determining the value of the stock. Accordingly, the court denied the estate's motion for partial summary judgment.

(4) On March 10, 2016, the Tax Court entered a stipulated decision finding an estate tax deficiency of $473,109 plus interest. This included an increase in the value of the company stock included in the gross estate of $410,730, which, at 2008's 45 percent rate, would account for $184,829 of the estate tax deficiency. The remaining $288,280 of estate tax deficiency, again at a 45 percent rate, suggests an increase in adjusted taxable gifts of about $640,620, or just under 20 percent of the $3,248,613 increase the IRS had asserted.

c. There is no reason to assume that the Tax Court's reasoning in these summary judgment contexts affects the substantive burden of proof regarding section 6501(c)(9), discussed in Parts 8.b(5)(b) and 12.e(5) above.

15. Structuring Transactions and Disclosures

a. In General

(1) While many routine gifts, particularly of cash or marketable securities, are not greatly affected by these rules, more complicated and sophisticated gifts will require more care in the structuring of the transaction and in the preparation of gift tax returns.

(2) There will also be more gift tax returns merely to fix the value of nontaxable gifts, such as gifts that qualify for the annual exclusion, and to report non-gift transactions such as intra-family sales, which the regulations specifically allow.

b. Particular Strategies Involving the Structuring of Transactions

(1) If possible, it can be helpful to "preview" the required gift tax disclosure even before a transaction is structured, a technique is implemented, or a transfer is made. Thinking about the scrutiny of a gift tax audit – or even the preliminary review that a return receives in the Service Center – can help expose unnecessarily risky elements of the transaction that might be changed. Usually, though, once the client and the advisers are satisfied that a transaction is sound, it is rare that it would be changed in any fundamental way just to "look good."

(2) One rule of thumb that is sometimes helpful is to consider, hypothetically, whether the transaction would be a good one to take to the Internal Revenue Service in a ruling request.

(a) Usually the answer is no, but it can be helpful to determine what there is about the transaction that makes the answer no. If the warts can be eliminated or reduced without compromising the essence of the transaction, perhaps they should be.

(b) Bear in mind, though, that the decision to submit a ruling request is in many respects not comparable to preparation of a return. For one thing, there is a 100 percent examination rate for ruling requests!

(3) Some examples of what to avoid unless they are essential to the transaction are transitory entities, similar reciprocal transfers, passthrough or earmarked transfers (*i.e.,* from *A* to *B* and then from *B* to *C*), and other indications of artificiality.

(4) If a contemporary appraisal is needed to make the transaction real or bona fide, then get one.

(5) Transfer techniques that depend on various "defined value" formulas can be wonderful ways to manage risks and even "audit-proof" a return, but beware of a formula expressed in terms of values as "finally determined" unless sufficient disclosure is contemplated that there will be no doubt that the statute of limitations runs and finality is achievable. (See the discussion of the use of a "defined value clause" in Part 8.c of Grantor Retained Annuity Trusts (GRATs) and Installment Sales to Grantor Trusts found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.)

(6) A transaction that presents potential issues of estate tax includibility (such as under section 2036) is especially challenging, because there is no way to start the estate tax statute of limitations running during the decedent's life!

c. Particular Issues Involving the Preparation of Gift Tax Returns

(1) Generally, when a gift is required to be reported on a gift tax return, full disclosure is best, attempting to comply with every element of one of the disclosure safe harbors in the regulations.

(2) Sometimes appraisals are accompanied by spreadsheets and similar presentations of the appraiser's analysis and calculations. The question is sometimes raised whether disclosure would be enhanced by the submission of such spread-sheets **electronically** as well as in printed form, so as to help the reader "replicate the process and arrive at the appraised value." Reg. §301.6501(c)-1(f)(3)(ii)(E).

(a) Generally, it is probably a bad idea to do that and incur the risk of distracting an IRS examiner.

(b) But it is often a good idea for the "soft" version to be reviewed in connection with the review of the appraisal and the return by the lawyer and/or return preparer.

(3) Disclosure strategy should also take into account the question at the top of Schedule A of the federal gift tax return (Form 709, Nov. 2013): "Does the value of any item listed on Schedule A reflect any valuation discount?" When this question first appeared in the December 1996 version of the return, the strategy of choice appeared to be to avoid checking this box if possible. With the expansion of section 6501(c)(9), the strategy of choice may actually be to check the box, so as to reduce the doubt that the disclosure is adequate.

(4) Disclosure strategy should likewise take into account the questions on the federal estate tax return (Form 706, Revised, *e.g.,* August 2019).

(a) Part 4 (General Information) on page 3 includes the following questions:

> **13a** Were there in existence at the time of the decedent's death any trusts created by the decedent during his or her lifetime?
>
> **b** Were there in existence at the time of the decedent's death any trusts not created by the decedent under which the decedent possessed any power, beneficial interest, or trusteeship? …
>
> **e** Did the decedent at any time during his or her lifetime transfer or sell an interest in a partnership, limited liability company, or closely held corporation to a trust described in lines 13a or 13b?
>
> If "Yes," provide the EIN number for this transferred/sold item.

(b) These questions raise questions. For example:

i. "… the decedent …" Does this question apply, for example, to a sale by a single-member LLC owned by the decedent? Or a sale made by the decedent's spouse?

ii. "… to a trust …" Does this question apply, for example, to a sale to a single-member LLC owned by a trust?

iii. "… described in question 13a or 13b …"

a. "…created by the decedent …" or "…not created by the decedent under which the decedent possessed any power, beneficial interest, or trusteeship …" Does this question apply if someone else – say, a lawyer – creates the trust and the decedent merely funds it?

b. Is "in existence at the time of the decedent's death" part of the "described in" reference in question 13e?

c. What if the trust has been terminated (*1*) by its terms, (*2*) by pourover into another trust by its terms, (*3*) by a trustee's exercise of discretion, (*4*) by reformation or other modification, or (*5*) by "decanting" into another trust?

(5) Care in the overall preparation of a gift tax return can help maintain a "low profile" and avoid inviting undue attention. The following details are important and can help:

(a) Neatness.

(b) Rounding off to whole dollar amounts.

(c) Internal mathematical consistency.

(d) Compatibility between spouses' returns in the case of split gifts.

(e) Response to all relevant questions and completion of all relevant portions of the return, including the GST tax portion when applicable.

(f) Including the donor's basis.

(g) Specifying the **exact** date of the gift.

(h) Attaching Form 712 to document the interpolated terminal reserve of a life insurance policy.

(i) Double-checking all information, especially Social Security numbers.

(j) Ensuring that all signatures are affixed, including consenting spouses' signatures.

(6) When preparing a gift tax return, it is a good idea to routinely check prior gift tax returns, and, if there are errors, correct those errors, so as to put the current gifts in the correct tax bracket.

(7) Gift tax returns, like all returns, should be filed by certified mail, with return receipt requested, even if no tax is due.

d. The Challenge of Non-Gifts

(1) Under the final regulations, non-gifts will continue to be a challenge. Our professional culture resists reporting anything but gifts on a gift tax return.

(2) There will be a lot of such transactions reported on gift tax returns, however, perhaps especially in the near term, so it is probably wrong to believe that a stigma is attached to it. The Service has in effect asked for it in the regulations.

(3) Many of us will continue to be more comfortable if a transaction reported on a gift tax return does include a gift element. Often it will be possible to provide for that in the transaction. Examples include:

(a) In the context of an installment sale to a grantor trust (or any similar transaction), this could be a small gift element in a sale transaction (including a slight misstatement of the interest rate, so that the low-interest-loan rules apply) or the "seed money" or down payment that permits the trust to make the purchase. (Economically and analytically, these techniques are all equivalent.)

(b) In a context using a GRAT (perhaps as the pick-up of any value in excess of a formula-defined value), the small value of the remainder. (This is a good reason not to try to "zero out" either the amount passing to the GRAT or, if possible, the GRAT remainder itself.)

(4) The ultimate trade-off is between the gift tax repose that disclosure provides and the dual prospect that disclosure will itself trigger a gift tax audit and that everything on the gift tax return is likely to be reviewed at death when copies of the gift tax returns are filed with the estate tax return or provided later. One test might be to consider whether the item in question would have been examined anyway, even if it had been omitted from the gift tax return.

(a) For example, if a husband bequeaths 51 percent of the stock of a closely held corporation to his wife, and a few years later the wife dies owning 49 percent of the stock, an estate tax examiner is likely to figure that out and ask about it. Thus, if 2 percent of the stock was the subject of a sale transaction, there is less reason not to fully disclose the sale on a gift tax return, especially if the sale occurred in a setting in which the gift tax downside is minimized. That might be the case, for example, if the transfer is defined by formula, or if it is simply kept to a small amount (if 2 percent is not otherwise small enough).

(b) On the other hand, if it is the **corporation** that engages in a sale of an interest in land to a trust created by the wife for the benefit of the husband's and wife's grandchildren, and the wife still owns 51 percent of the stock at her death, then there is no reason to expect the land sale to be questioned in the ordinary course of the estate tax audit at the wife's death, and there is therefore a much greater incremental risk. The risk increases if the wife dies before the gift tax statute of limitations runs, but after the land (to everyone's surprise!) has been developed and sold for a huge profit. Unfortunately, the to-disclose-or-not-to-disclose analysis must be done on a case-by-case basis.

(c) The same analysis is appropriately applied to the funding of the marital bequest in the first place. It may be the first thing the estate tax examiner at the wife's death asks about.

e. The Wild Card of Privilege

(1) In general, there is no attorney-client or other privilege in communications and documents related to the preparation of tax returns. *United States v. Frederick,* 182 F.3d 496 (7th Cir. 1999), *cert. denied,* 528 U.S. 1154 (2000).

(2) The extent of the attorney-client privilege in ordinary estate planning contexts apart from tax return preparation is a close question. Furthermore, the potential for waiver of the privilege through disclosure to family members, other advisers, and the like is unusually great in an estate planning context. And the attorney work product privilege applies only to materials prepared "in anticipation of litigation" – not generally true of estate planning (except to the hardened cynic!).

(3) On balance, then, it is hard to tell if merely including a non-gift transaction on a gift tax return will alter the privileged nature of the communications and documents related to the transaction.

16. Selecting and Working with Appraisers

Under the statute of limitations rules, there will undoubtedly be a greater need both for formal appraisals and for more careful review of those appraisals in the preparation and review of gift tax returns. Doing a good job of selecting and working with appraisers is therefore more important than ever.

a. Characteristics to Seek in Selecting an Appraiser

(1) **Credentials.** How will this appraiser's written report and oral testimony be received? Is the appraiser experienced with appraising this type of asset? How has the appraiser's testimony been received and treated by courts? (This can be explored through a computer search.) How helpful and effective has the appraiser been in other cases that have not proceeded to judgment

and a written opinion? (This can be explored through networking.) The best appraiser to engage is one with whom the lawyer has worked before. But this is not always practical – "there's a first time for everything" – and the best alternative is to obtain copies of the appraiser's previous work-product, if possible, and to talk to other lawyers who have engaged that appraiser.

(2) **Independence.** Will the appraiser come across as an advocate for the taxpayer, rather than an objective witness whose first duty is to assist the court? If a business is involved and the appraiser is affiliated with the accounting firm that prepares and/or audits the financial statements of the business, will the appraisal seem objective?

(3) **Understandability, credibility, effectiveness.** Does the appraiser have the ability to communicate to an appeals officer or judge (or jury, if there is one) in a straightforward and understandable manner, both in writing and orally? Does the appraiser hem and haw, ramble, overuse aspirated pauses ("uh"), or have any other annoying habit? Does the appraiser generally use good English? Does the appraiser hold eye contact? Does it sound as if the appraiser is speaking from personal experience and judgment, rather than parroting some textbook approach or reciting what the lawyer wants to hear? In sum, does the appraiser project an image of competence, thoroughness, objectivity, confidence, and sincerity?

(4) **Adaptability.** Does the appraiser recognize the uniqueness of each assignment and tailor the approaches, methods, and presentations to the assignment? Or does the appraiser do "cookie cutter" work, showing more interest in a generic philosophy than in the facts of the case?

(5) **Responsiveness, timeliness.** Usually, the appraiser's input is needed to support the taxpayer in meeting certain deadlines. If the case develops into litigation, there will be plenty of important deadlines that must be met. If an appraiser shows difficulty providing what is needed when it is needed – from completing the engagement letter to returning phone calls to submitting written work-product – this could portend more serious difficulties later.

(6) **Ability and willingness to listen.** This is an often overlooked, but very important, trait. If a controversy proceeds to litigation and the appraiser is called upon to give a deposition or testify in court, it is critical that the appraiser understand and answer each question that is asked – nothing more, nothing less, and nothing else – and keep mental track of previous questions and answers, insofar as they bear on the question at hand. Loose cannons are loose cannons!

b. Special Considerations Suggested by Case Law

(1) An expert should be able to withstand being "*Daubert*ized."

(a) As a gatekeeper of expert testimony under the Federal Rules of Evidence, a judge may insist on being satisfied as to both the relevance and reliability of a proffered expert's testimony. *Daubert v. Merrell Dow Pharmaceuticals, Inc.,* 509 U.S. 579 (1993).

(b) Reliability may be measured by (i) the testing of technique or theory, (ii) peer review and publication, (iii) observed or potential error rate and standards of control for error, and (iv) acceptance within the relevant professional community. *Id.*

(c) These standards apply as appropriate to all experts, not just scientists, and may be applied by the trial judge with flexibility. *Kumho Tire Co. v. Carmichael,* 526 U.S. 137 (1999).

(2) In a celebrated case involving the valuation of real estate over a 204-year period, an appraiser, after a week-long *Daubert* hearing, was rejected as an expert, in part because he had employed "an intuitive approach in selecting comparable sales," had made no adjustments for location, size, and similar factors, had operated with time and budgetary constraints, and as a result had produced what the court viewed as an "apples and oranges comparison." *Cayuga Indian Nation of New York v. Pataki,* 83 F. Supp. 2d 318, 324-27 (N.D.N.Y. 2000).

(3) Tax Court opinions also can provide insight into the paces that an appraiser can be expected to be put through. *See, e.g., McCord v. Commissioner,* 120 T.C. 358 (2003), *rev'd,* 461 F.3d 614 (5th Cir. 2006); *Kohler v. Commissioner,* T.C. Memo. 2006-152; *Peracchio v. Commissioner,* T.C. Memo. 2003-280; *Lappo v. Commissioner,* T.C. Memo. 2003-258; *Estate of Kaufman v.*

Commissioner, T.C. Memo. 1999-119, *rev'd sub nom. Morrissey v. Commissioner,* 243 F.3d 1145 (9th Cir. 2001); *Mandelbaum v. Commissioner,* T.C. Memo. 1995-255, *aff'd without opinion,* 91 F.3d 124 (3d Cir. 1996).

(4) *See also Harding v. Commissioner,* T.C. Memo. 1995-216 (holding that taxpayers' "relatively unquestioning reliance" on an appraisal that "was purely hypothetical, and … not based on the appraisers' personal knowledge" was "not reasonable under the circumstances" and did not permit the taxpayers to avoid a negligence penalty); *Estate of Tanenblatt v. Commissioner,* T.C. Memo. 2013-263 (appraisal attached to estate's petition not allowed into evidence where the estate was unable to produce the appraiser to testify because of a fee dispute between the appraiser and the estate and the estate failed to qualify the appraiser as an expert pursuant to Rule 702 of the Federal Rules of Evidence).

c. The Pros and Cons of Engaging More than One Appraiser

(1) In the valuation of a business, for example, appraisers might be assembled from several sources, including full-time business appraisers, economists, industry specialists, accountants, and investment bankers.

(2) While presenting a large number of witnesses whose testimony is cumulative could be boring and annoying, and could even make the taxpayer appear to be "up to something," it can be effective if handled sensibly.

(3) Moreover, duplication will make it possible to use some appraisers and not others, if, for example, some are not responsive or seem to be "coming out wrong." Because of the latter possibility, it is important that the formal engagement of the appraiser be a matter between the lawyer and the appraiser, in an effort to treat unused appraisers' reports, correspondence, drafts, etc. as attorney work-product. In addition, in an estate context, discretion should be used in claiming the cost of an unused appraisal as a deductible estate administration expense.

(4) The donor or executor will understandably be concerned about cost. But in a large case, money spent for sound appraisal assistance almost always is rewarded many times over in tax saved.

(5) In addition, the deductibility of appraisers' fees and expenses can provide considerable leverage, especially in an estate tax audit. For example, if an appraiser's fee paid in the course of Tax Court litigation five years after the due date of the estate tax is deducted for estate tax purposes as an administration expense under section 2053, the deduction of every dollar, taking into account interest on tax at a rate of 3 percent, will entitle an estate subject to a 40 percent estate tax rate to a refund, with interest, of approximately 46.4 cents, or an offset of a deficiency payment of approximately 43.6 cents. That means that, in effect, the government must pay all of its own expenses and nearly half of the estate's expenses. A proposal in the current Treasury-IRS Priority Guidance Plan to address "the application of present value concepts in determining the deductible amount of expenses" might reduce that impact, but only slightly (perhaps 40 cents instead of 43.6 cents in the case of the reduction of a deficiency payment).

d. Identifying the Appraiser's Objective

(1) Generally, the appraiser should be asked to form and present an opinion of "fair market value" (essentially by a willing-buyer-willing-seller standard) which is the same in any tax or non-tax context and is the same whether the other party is the Internal Revenue Service or another family member or business partner or an unrelated investor.

(2) This does not mean, however, that there are not sometimes circumstances, such as achieving equity among family members or between family and non-family partners, where it is necessary to explicitly override the "fair market value" standard, because in such **divisions** (unlike a willing-buyer-willing-seller transaction) the sum of the parts necessarily equals the whole.

(3) Furthermore, while ordinarily it is unnecessary and even inappropriate for an appraiser to address **legal** matters, it will now be essential to make sure, before they are engaged, that appraisers are familiar with the disclosure rules of Reg. §301.6501(c)-1(f).

Appendix: Chief Counsel Advice 200221010

February 12, 2002

CC:PA:APJP:Br2
POSTF-160250-01
UILC: 6501.00-00

INTERNAL REVENUE SERVICE NATIONAL OFFICE CHIEF COUNSEL ADVICE

MEMORANDUM FOR:	ASSOCIATE AREA COUNSEL - Area 4 (Large and Mid-Size Business) CC:LMSB:NR:4
FROM:	Assistant Chief Counsel (Administrative Provisions & Judicial Practice) CC:PA:APJP
SUBJECT:	Gift Tax Exceptions to the 3 Year Period of Limitations

This Chief Counsel Advice responds to your memorandum dated November 7, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

LEGEND

Taxpayer =

Taxpayer's Wife =

ABC LLC =

ISSUES

(1) Whether Taxpayer's gift tax return failed to show a gift such that the period of limitations is held open pursuant to I.R.C. § 6501(c)(9) with respect to Taxpayer's gift tax return.

(2) Whether Taxpayer's gift tax return contained a substantial omission such that the period of limitations is held open pursuant to I.R.C. § 6501(e)(2) with respect to Taxpayer's gift tax return.

CONCLUSIONS

Section 6501(c)(9) provides an exception to the general 3-year period of limitations in the case of gift tax on certain gifts not shown on a gift tax return. In addition, section 6501(e)(2) provides an exception to the general 3-year period of limitations in the case of a gift tax return with a substantial omission. We conclude that Taxpayer did not disclose the gifts in a manner adequate to apprise the Service of the nature and amount of the gifts. Therefore, Taxpayer's period of limitations is held open indefinitely in accordance with section 6501(c)(9). In the alternative, Taxpayer's period of limitations is held open for 6 years in accordance with section 6501(e)(2).

FACTS

ABC LLC was formed in 1997 as a limited liability company under Delaware law and treated as a partnership for federal tax purposes. At the time of formation, Taxpayer was a member in ABC LLC and held a 1% interest. Through a series of transactions not relevant to the determination of the issues in this case, Taxpayer acquired an additional 19% interest in ABC LLC. Taxpayer's entire 20% interest was composed of Class B units.

On April 7, 1997, Taxpayer gifted the 19% interest in ABC LLC to a generation- skipping trust. On that same day, Taxpayer gifted the remaining 1% interest in ABC LLC to a family trust. Taxpayer and Taxpayer's Wife split the value of both gifts in accordance with section 2513 of the Internal Revenue Code. Taxpayer filed his gift tax return (Form 709) on October 9, 1998 and attached the following description of the gifts: "Class B units in ABC LLC. Units acquired on 4/6/97 for $200,000 cash." In addition, Taxpayer indicated that the gifts were made on 4/7/97 with a value on that date of $200,000 and an adjusted basis of $200,000. Taxpayer's Form 709 was due on April 15, 1998 and therefore was not timely filed.

The Service maintains that the fair market value of Taxpayer's transfers to the two trusts at the time of the transfers was $14 million. The Service proposes to issue a notice of deficiency to Taxpayer for the 1997 tax year for the deficiency in gift tax. The Service has raised the question of whether it may rely on the exception for gifts not adequately shown on a return as a defense to the argument that the period of limitations for assessing deficiencies has expired with respect to Taxpayer's 1997 gift tax liability. In the alternative, the Service has raised the question of whether it may rely on the exception for a substantial omission of gifts as a defense to the argument that the period of limitations for assessing deficiencies has expired with respect to Taxpayer's 1997 gift tax liability.

LAW AND ANALYSIS

Section 6501 of the Internal Revenue Code provides that, except as otherwise provided, tax must be assessed within 3 years after the return was filed, whether or not such return was filed on or after the date prescribed. As an exception, section 6501(c)(9) extends the period of limitations indefinitely if a gift of property, the value of which is required to be shown on a gift tax return, is not shown on such return. This exception does not apply, however, "to any item which is disclosed in such return, or in a statement attached to the return, in a manner adequate to apprise the Secretary of the nature of such item." I.R.C. § 6501(c)(9). Thus, to obtain the benefit of the exception in section 6501(c)(9), the Service must show: (1) that the value of the gift was required to be shown on a gift tax return; and (2) the gift was not disclosed in the gift tax return or in any statement attached to the return in a manner sufficient to apprise the Service of the nature of the gift.

As another exception, section 6501(e)(2) extends the period of limitations to 6 years where the taxpayer omits from the total amount of gifts made during the period for which the gift tax return was filed an amount which exceeds 25% of the total amount of gifts stated on the return. In determining the items omitted from the total gifts, there shall not be taken into account any item which is omitted from the total gifts stated in the return "if such item is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Service of the nature and amount of such item." I.R.C. § 6501(e)(2). In addition, when determining whether a 25% omission exists, any increases in the valuation of assets disclosed on the gift tax return are not taken into account. Treas. Reg. § 301.6501(e)-1(b)(2). Thus, to obtain the benefit of the exception in section 6501(e)(2), the Service must show: (1) that the omitted items were properly includible in total gifts for the calendar year, (2) the omitted items comprised more than 25% of the total gifts shown on the return, and (3) the information on the gift tax return or on any statement attached to the return was not sufficient to apprise the Service of the nature and amount of the omitted item.

Neither the Code nor the Treasury regulations provide guidance on what constitutes "a manner adequate to apprise the Service of the nature and amount of such item." Moreover, we have found no gift tax cases interpreting the adequate disclosure standards of sections 6501(c)(9) or 6501(e)(2). However, we note that section 6501(e)(1) provides a similar exception to the period of limitations for a substantial omission of items in the income tax context and section 6501(e)(1)(A)(ii) contains identical language regarding adequate disclosure. The Tax Court has recognized that "an examination of section 6501(e)(1) and (2) shows that the two are in pari materia in dealing with the same subject—the application of the statute of limitations—and, accordingly, we may give due consideration to income tax cases in deciding estate tax cases on this same subject." Estate of Williamson v. Commissioner, T.C. Memo. 1996-426. While this decision was in the context of the period of limitations exception for the substantial omission of items from the gross estate, we see no reason why the same standard should not apply in the gift tax context. Moreover, the legislative history for section 6501(e)(2) indicates that section 6501(e)(2) "applies to estate and gift taxes a rule, corresponding to the income-tax rule." S. Rep. No. 83-1622, at 584 (1954); H.R. Rep. No. 83-1337, at 414 (1954). In addition, because section 6501(c)(9) also utilizes the "manner adequate to apprise the Secretary" language, we believe the same adequate disclosure standard should apply. Thus, income tax cases construing the adequate disclosure standard in the context of a substantial omission of items can be used as guidance for determining whether there has been adequate disclosure for purposes of sections 6501(c)(9) and 6501(e)(2).

The disclosure required to trigger section 6501(e)(1) and avoid application of the extended period of limitations has been held to require production of a "clue" with respect to the omission of income. University Country Club, Inc. v. Commissioner, 64 T.C. 460, 470 (1975). "[T]his does not mean simply a 'clue' which would be sufficient to intrigue a Sherlock Holmes. But neither does it mean a detailed revelation of each and every underlying fact." George Edward Quick Trust v. Commissioner, 54 T.C. 1336 (1970), aff'd per curiam, 444 F.2d

90 (8th Cir. 1971). The disclosure must be sufficiently detailed that a decision whether to select the return for audit may be a reasonably informed one. Estate of Fry v. Commissioner, 88 T.C. 1020, 1023 (1987) (citation omitted). Moreover, the 6-year period of limitations applies where there is either a complete omission of an item of the requisite amount or misstating of the nature of an item. Phinney v. Chambers, 392 F.2d 680, 685 (5th Cir. 1968). In either situation, the Service is at a disadvantage in detecting errors and consequently needs more time to uncover those errors. Id.

Turning now to the question of whether there was sufficient information on Taxpayer's gift tax return to apprise the Service of the nature of the interests in ABC LLC, we note that the regulations that correspond with section 6501(c)(9) contain detailed guidance on what constitutes adequate disclosure of transfers of property reported as gifts. In this regard, Treas. Reg. § 301.6501(c)-1(e) sets detailed guidelines for a transfer of property subject to the special valuation rules of section 2701 or section 2701, while Treas. Reg. § 301.6501(c)-1(f) sets detailed guidelines for gifts made after December 31, 1996 not adequately disclosed on a return filed after December 3, 1999. Based on the facts submitted, we cannot determine whether Taxpayer's transfers of interests in ABC LLC were subject to the special valuation rules of sections 2701 or 2702. Thus, we cannot determine whether the adequate disclosure standard of Treas. Reg. § 301.6501(c)-1(e) is applicable in this case. Moreover, we note that Taxpayer and Taxpayer's Wife filed gift tax returns for the 1997 calendar year prior to December 3, 1999, (the effective date of the regulations) making Treas. Reg. § 301.6501(c)-1(f) also inapplicable. See Treas. Reg. § 301.6501(c)-1(f)(8). Nonetheless, both regulations illustrate the type of information that should be on the return (or a statement attached thereto) for the return to commence the running of the period of limitations on assessment. In particular, a gift tax return (or statement attached thereto) should contain, at a minimum, a description of the transferred property, the identity of the transferor and each transferee, the relationship between those parties, and a description of the method used to determine the value of the gift. In addition, for a transfer of property in trust, the gift tax return should contain a description of the terms of the trust. Moreover, the Service has indicated that where a donor files a gift tax return but fails to adequately disclose a gift because the information required under Treas. Reg. § 301.6501(c)-1(f)(2) for the gift was not submitted with the return, the period of limitations on assessment with respect to that return does not begin to run. Rev. Proc. 2000-34, 2000-2 C.B. 186.

While the effective date of the regulations under section 6501(c)(9) and the publication date of the revenue procedure make them inapplicable in this case, the principles upon which they are based are implicit in section 6501(c)(9) itself. The statute requires that information about the nature and amount of the gift must be included on the return (or statement attached thereto). The regulations under section 6019 illustrate the type of information a gift tax return should contain. First, the gift tax return must contain "the fair market value of all gifts not made in money." Treas. Reg. § 25.6019-3(a). In addition, "[t]he instructions printed on the return should be carefully followed." Id. Further, the gifts made during the calendar year "must be listed on the return and described in a manner that they may be readily identified." Treas. Reg. § 25.6019-4. See also Instructions to Form 709, p. 5 ("Describe each gift in enough detail so that the property can be easily identified.") While there are no examples in the Treasury regulations or the Instructions to Form 709 pertaining to ownership interests in a limited liability company, we believe information similar to that required for a gift of stock should be contained on the gift tax return. In this regard, the gift tax regulations provide the following:

> Description of stocks shall include number of shares, whether common or preferred, and, if preferred, what issue thereof, par value, quotation at which returned, exact name of corporation, and, if the stock is unlisted, the location of the principal business office, the State in which incorporated and the date of incorporation, or if the stock is listed, the principal exchange upon which sold.

Treas. Reg. § 25.6019-4.

Analogizing the requirements for a gift of stock to a gift of an interest in a limited liability company, we conclude that the description of a gift of an interest in an LLC should include the number of units in the limited liability company, the class type, and the percentage of ownership interest that the gift represents.

In the present situation, we conclude that the Taxpayer did not include an adequate description of the gifts to the two trusts. In particular, Taxpayer did not identify the number of units in ABC LLC being transferred, the percentage of ownership interest that those units represented, or the nature of Class B interests. Taxpayer only identified the name of the limited liability company, the purported value and the fact that the units were Class B units. This information did not allow the Commissioner to make a reasonably informed decision whether to select the return for audit. Nor do we believe that Taxpayer may legitimately argue that the absence of detailed information on the return should itself have given the Commissioner a "clue" to look for the missing information. We believe that in enacting section 6501(c)(9), Congress intended that taxpayers should fully disclose the nature of their gifts on the return or attachments thereto-not simply leave a trail of questions for the Commissioner to pursue. Therefore, we conclude that Taxpayer did not adequately disclose the nature of the gifts. Consequently, the period of limitations on assessment with respect to Taxpayer's gift tax return remains open.

Turning now to whether section 6501(e)(2) applies in this case, we note that the total amount of gifts stated on Taxpayer's return was $200,000. In order to apply the 6-year period of limitations on assessment to Taxpayer's return, the Service must prove that items properly includible in total gifts for that calendar year in excess of $50,000 were omitted. Taxpayer's gift tax return discloses Class B units in a limited liability company. The fair market value of the Class B units at the time the gifts were made was $14 million. In accordance with section 2503, those gifts were subject to gift tax. Because the fair market value of the Class B units is in excess of 25% of the total gifts stated on Taxpayer's return, we conclude that there has been a substantial omission of items within the meaning of section 6501(e)(2). As discussed above, Taxpayer did not adequately disclose the nature and amount of the omitted items. Therefore, the tax due on the transfers can be assessed at any time on or before October 9, 2004.

<u>CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS</u>

… [six lines redacted] To the extent the transfers of interests in ABC LLC were subject to special valuation, Taxpayer did not adequately disclose the transfers in accordance with Treas. Reg. § 301.6501(c)-1(e)(2).

Although not raised in your request for advice, we note that the same analysis that applies to the Taxpayer with regard to the exceptions to the usual period of limitations on assessment also applies to Taxpayer's Wife who agreed to split the gifts pursuant to section 2513.

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney-client privilege. If disclosure becomes necessary, please contact this office for our views.

If you have questions, please contact (202) 622-4940.

CURT G. WILSON
Administrative Provisions & Judicial Practice