

Information reporting and basis consistency required for certain estates

ESTATES: New law brings changes and many questions.

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Guest Contributor

The Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 (the "Act") requires estates that are required to file estate tax returns, to file information returns with the IRS and the beneficiaries.¹ These statements report the basis of the assets. The new law also adds a new basis rule requiring beneficiaries to use the basis as reported by the estate, if the estate is a taxable estate.

Basis reporting to the IRS and the beneficiary

An executor of an estate that is required to file an estate tax return — generally those with a gross estate greater than the basic exclusion amount of \$5,430,000 in 2015 — must report values of each interest and other information to the IRS and to each beneficiary acquiring an interest in the property.² These statements must be filed at such time as the IRS may prescribe, but in no case later than the earlier of:

- 30 days after the estate tax return was required to be filed including extensions; or
- 30 days after the date the return is filed.³

The requirement applies to any gross estate that exceeds the basic exclusion amount.

These rules only apply if an estate tax return is required. If the sole reason for filing the estate tax return is to make the portability election (DSUE), that does not appear to be considered a required return for this purpose.⁴

It is possible, however, that the IRS may interpret the statute differently.

Reporting starts July 2015 — but postponed

Information returns are required for estate tax returns filed after July 31, 2015, the date of enactment, even if the date of death was before that date. However, in Notice 2015-57, the IRS postponed the due date for the required statements to the IRS and the beneficiaries until at least February 29, 2016, even if they are due prior to that date under the statutory rules listed above. The notice also says executors should not attempt to comply with the statement reporting prior to the IRS issuing their rules and the forms. At that time, we hope it will be clear if there is a filing requirement for returns filed solely to make the DSUE election.

If the value of the assets change after the initial information return filing, a supplemental statement must be filed not later than 30 days after the adjustment is made.⁵

Prior to this change, information returns were not required, and estates were not required to communicate the basis of the assets to the beneficiaries. Thus, even in taxable estates, beneficiaries often did not know what the estate reported as the fair market value of each asset unless they were also the executor or trustee.

EXAMPLE 11-7: A son inherited the family vacation home from his parents. Years later, when he sells the home, his sister who was the sole executor doesn't remember if there was an estate tax return, and she has no records. Unless he can get her to request a copy of the return from the IRS (assuming they still have it in their records) he will have to make an educated guess. If he inherited the property after the Act passed and an estate tax return was required, he would have received a statement telling him the basis of the home reported by the estate.

Penalty for failing to file information returns

Failure to file the required information returns will result in a penalty of \$100 (prior to 2016) or \$250 (after 2015) per return or statement. If the failure is due to intentional disregard, it is raised to the greater of \$250 (or \$500 per failure after 2015) or 10% of the aggregate amount of the proper amount that was supposed to be reported.⁶

Basis consistency with the estate

If there is a taxable estate, there are new rules that require the beneficiary to use the basis reported on the Form 706, even if that basis is lower than the fair market value. These new rules only apply if the property's inclusion in the decedent's estate increased the estate tax liability. Therefore, if there is no estate tax due, these new rules don't apply because the inherited assets didn't "increase the liability for the (estate) tax."⁷ If no return is required due to the small size of the gross estate, the basis consistency provisions also would not apply.

When beneficiaries must use the estate tax basis (or less)

The Act added to IRC §1014 (Basis of property acquired from a decedent) subsection (f), titled "Basis must be consistent with the estate tax return." IRC §1014(f)(1) states that the basis of inherited property shall not exceed:

A. In the case of property the "final value of which has been determined" for purpose of the estate tax, that value; and

B. In the case of property not described in (A), with respect to which a statement has been furnished to the IRS under IRC §6035(a), the value furnished to the IRS.

For the above purpose, the "basis of property has been determined" if:

- The value of the property is shown on an estate tax return, and the value is not contested by the IRS before the expiration of the statute of limitations;
- In a case not described in (A), if the value is specified by the IRS and such value is not timely contested by the executor of the estate; or
- The value is determined by a court or pursuant to a settlement agreement with the IRS.

When applicable, the basis that will apply is initially the amount reported on the Form 706 until it is amended. If the statute of limitations expires and the IRS does not contest the values, those values will continue to be the basis if there is a taxable estate. If the estate is audited, a new basis will apply to any asset whose basis was changed.

Prior law

IRC §1014 provides that the basis of property acquired from a decedent is the fair market value at date of death (unless it is income in respect of a decedent). Treas. Regs. §1.1014-3(a) states that basis shall be the value as "appraised" for federal estate tax purposes. (Generally only real estate is appraised when preparing an estate tax return.) If there is no estate tax return, the basis is the value used for state inheritance, or transmission tax is used. This was modified by Rev. Rul. 54-97, which states that the estate tax value is not conclusive and that the actual fair market value applies, if different.⁸ The estate tax value will apply, however, if the beneficiary and the executor or trustee is the same person.⁹

Courts have allowed either the taxpayer or the IRS to use a fair market value different from that reported on the estate tax return where the estate's value was incorrect.¹⁰ When the executor and the taxpayer are the same person, inconsistent positions generally will not be allowed.

This actual fair market value rather than estate tax value continues to apply when there is a nontaxable estate because the new section does not apply.

Practical application

The new provision says that the basis of inherited property “shall not exceed” the basis as finally determined. If the estate tax return overvalued the property, this implies that the beneficiary should reduce their basis to the lower actual fair market value. It would have been more instructive if the statute had said, “the amount reported on the estate tax return or the fair market value at date of death, whichever is lower.”

EXAMPLE 11-8: A taxable estate reported 100 shares of IBM stock at \$54 per share, which was a typo. The actual value was \$45 per share on the date of death. The taxpayer should report the actual \$4,500 fair market value as basis. If not, is the taxpayer subject to an overvaluation penalty if they use the reported \$5,400? As a practical matter, why would a beneficiary verify the accuracy of the reported date of death value when they receive a basis statement on an IRS form telling them they must use the reported value?

EXAMPLE 11-9: Same facts as Example 11-8, but reversed. A taxable estate reported the value of 100 shares of IBM stock as \$4,500 rather than the actual \$5,400. In that case, the beneficiary must use the reported amount as their basis, as the basis cannot exceed the amount reported. In this situation, if the estate was not a taxable estate, even if it was required to file an estate tax return and an information return, it appears the beneficiary can use the fair market value of \$5,400 as would have occurred under the pre-Act law, as the Act's basis provisions would not apply.

Penalties for inconsistent basis reporting

If a tax return subject to these rules reports “any inconsistent estate basis,” then under IRC §6662(b)(8), any portion of the underpayment is subject to a 20% penalty. An inconsistent estate basis exists if the basis of property claimed on the tax return exceeds the basis as determined under IRC §1014(f).

Future guidance

The IRS will publish rules to explain and implement these changes. These are a few practical issues that we hope will be addressed:

- How does an estate with multiple beneficiaries meet the 30-day rule when the assets have not yet been allocated or distributed to the beneficiaries? This rarely occurs within 30 days of filing the estate tax return.
 - Does the estate send each beneficiary a copy of a statement listing all of the assets without saying who receives which asset if the allocations have not yet been determined?
 - Does the estate file with the IRS but defer the filing with the beneficiaries until the distributions are made?
 - Is there an exception so that only specific information related to that beneficiary can be sent for those who are receiving a specific bequest?
- What does a beneficiary do if an asset is received and sold before March 2016, prior to the date the information returns are sent?
- What is the burden of a beneficiary to determine if the fair market value that was reported to the IRS and to the beneficiary exceeds the actual fair market value?
- In the situation where information returns are filed but the estate was not a taxable estate, must the taxpayer disclose an inconsistent position if using the actual fair market value?
- If a beneficiary sells an asset in 2016 and reports the amount provided by the estate after the sale, and two years later the estate is audited and the value changed, is the beneficiary required to amend their return, or is it voluntary and not subject to an undervaluation penalty because it was accurate at the time it was filed?

How new rules apply

	Must report estate tax value to IRS and to beneficiaries	Beneficiaries must use value used on the Form 706	Beneficiaries must use FMV if lower than Form 706 value
Estate with no filing requirement	No	No	N/A — no Form 706 filed
Estate with filing requirement but no tax due	Yes	No	Must use FMV
Estate with tax liability	Yes	Yes	Yes — if FMV is lower than the amount on Form 706

Subscribers to *Spidell's Federal Taxletter*[®] may access a special report, "New 2015 Rules on Basis of Assets Acquired From an Estate," which includes additional information and examples at:

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¹ H.R. 3236

² IRC §6035(a)(1) and (2)

³ IRC §6035(a)(3)(A)

⁴ See Steven R. Akers, Legislation Requiring Consistency of Basis with Estate Tax Value and Requiring Information Reporting, page 3, at www.bessemertrust.com/portal/binary/com.epicentric.contentmanagement.servlet.ContentDeliveryServlet/Advisor/Presentation/Print%20PDFs/Basis%20Consistency%20Legislation_08.2015.pdf

⁵ IRC §6035(a)(3)(b)

⁶ IRC §§6721, 6722

⁷ IRC §1014(f)(2)

⁸ 1954-1 C.C. 113

⁹ *Beltzer v. U.S.* (1974) 495 F.2d 211

¹⁰ *Johnson v. Comm.* (1959) 270 F.2d 134