IRS Form 8971 and Schedule A finalized — estate tax basis reporting

ESTATE TAX: Reporting is not required if the only reason for filing the estate tax return is to make the portability election or take the generation-skipping transfer tax exemption.

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Taxpayers filing estate tax returns (IRS Form 706) after July 31, 2015, because the gross estate exceeded the credit amount are required to file Form 8971 and distribute Schedule A to their beneficiaries. The credit amount is $5,430,000 in 2015 and $5,450,000 in 2016.

General filing requirements

Generally, the due date is the earlier of:

- 30 days after the date on which Form 706 is required to be filed (including extensions); or
- 30 days after the date Form 706 is actually filed.

However, all Forms 8971 and Schedules A that were filed after July 31, 2015, and before March 31, 2016, are due March 31, 2016. The March 31 due date applies if Form 706 was filed after July 31, 2015, whether or not Form 706 was timely filed.

If the only reason for filing the estate tax return was to take the generation-skipping transfer tax exemption or to make the portability election, Form 8971 and Schedule A are not required.[1]

If the beneficiary is a trust, estate, or business entity, the executor must furnish the statement to the trustee, executor, or to the business entity itself, not to the trust or estate's beneficiary or the owner of the business.[2]

Separate Form 8971 and Schedule A penalties will be assessed for late filing of the required forms. There does not appear to be any extension available for these filing and mailing requirements.

The Form 8971 is filed with the IRS in Cincinnati, Ohio. The Schedule A forms must be either given in person to an individual beneficiary, sent by e-mail, by USPS to the beneficiary's last known address, or by one of several listed FedEx or UPS delivery methods. The executor or trustee must keep separate proof of mailing and proof of delivery.

As to specific beneficiaries, a TIN or Social Security number is required, and a return that says none or unknown will cause the return to be incomplete and may make it subject

to a penalty. If the executor is unable to locate a beneficiary by the due date of the return, that should be reported and an explanation provided on the return. When the beneficiary is located, a supplemental return is required within 30 days.

Supplemental filings

If the amounts reported on the initial Schedule A filed with the IRS or provided to a beneficiary do not reflect the final values because of a change of value due to an audit or amended return, a supplemental Form 8971 and Schedule A must be filed no later than 30 days after the adjustment. Beneficiaries should only receive their own Schedule A. They do not receive a copy of Form 8971 or a copy of the other beneficiary's Schedule A.

When the actual distributions are made, it appears that supplemental Schedule A forms will be required to reflect the actual distributions, although no details are provided. Thus, if an executor simply lists all property on the initial filing of Schedule A for each beneficiary, then a supplemental Schedule A is not required, but one may be filed.

Property to be reported

The property to be reported on the information return includes all property with four exceptions:

- Cash, other than coins or paper bills with numismatic value;
- Income in respect of a decedent;
- Items of tangible personal property for which an appraisal is not required under Treas. Regs. §20.2031-6(b); and
- Property that is sold or otherwise disposed of by the estate and therefore not distributed to a beneficiary, in a transaction in which capital gain or loss is recognized.[3]

Schedule A asks for a description of the property, the valuation date, and the estate tax value (in U.S. dollars). It also asks, "Did this asset increase estate tax liability? (Y/N)" The instructions state that any property that qualifies for the marital or charitable deduction should be answered "N."

If it is unknown which assets will be distributed to which beneficiary at the time of the filing, the instructions state, "The executor must list all items of property that could be used, in whole or in part, to fund the beneficiary's distribution on that beneficiary's Schedule A." The result is that the same property may be reflected on more than one Schedule A.

The unknown practical question is what to do if actual distributions are not determined at the time of the filing and the beneficiary is receiving something other than a specific bequest. Should all properties except specific bequests to another beneficiary be listed on each of the beneficiary's Schedule A? Probably that is the best option unless it is determined that the beneficiary will get cash.

The effect may be to list most of the estate's property so that a nephew or cousin would know the value of the decedent's estate, even though that may violate confidentiality and the reason people use trusts to avoid probate and the public disclosure of their net worth. Moreover, it may mislead a beneficiary into believing that he or she is inheriting all of the assets listed on his or her Schedule A.

Adjustments to values

The regulations clarify that the basis of inherited property can be adjusted for subsequent events such as improvements or depreciation.[4]

If the recipient of inherited property subject to the reporting rules distributes or transfers (by gift or otherwise) all or a portion of that property to a related transferee, whether directly or indirectly, in a transaction in which the transferee's basis for federal income tax purposes is

determined in whole or in part with reference to the transferor's basis, the transferor is required to file and furnish with the IRS and the transferee, respectively, a supplemental statement documenting the new ownership of this property. It is not clear if this affects transfers to a revocable living trust.

EXAMPLE 4-1: Joy inherits the family farm. Years later, she gifts it to her children. She must report this to the IRS and to her children so they know the carryover basis.

If estate property is discovered after the filing of the return, there are two possible results. If the return is amended, then the basis will be reflected on a supplemental Schedule A. If the due date has passed or the return isn't amended, then the basis for this property is zero.

EXAMPLE 4-2: Dad dies with a taxable estate of $30,000,000, which omits his stamp collection worth $1,000,000. This is discovered after the statute of limitations expires. Whoever inherits this collection receives a tax basis of $0. If Dad had died without a taxable estate or if Mom inherited everything so that these rules do not apply, the basis would be $1,000,000.

About the Author

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[1] Treas. Regs. §1.6035-1(a)(2)

[2] Prop. Treas. Regs. 1.6035-1(c)(2)

[3] Prop. Treas. Regs. §1.6035-1(b)(1)

[4] Prop. Treas. Regs. §§1.1014-10(a)(2), 1.6662-8(b)