

IRS Proposed Regulations Concerning Basis Consistency and Reporting for Property Acquired from a Decedent



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On July 31, 2015, President Obama signed into law the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, sometimes referred to as the “Highway Act.” The Highway Act, among other things, added new provisions in Sections 1014(f) and 6035 of the Internal Revenue Code (IRC) concerning basis consistency and reporting for property acquired from a decedent. These new statutory provisions apply to Federal estate tax returns filed after July 31, 2015 and have two primary components: (1) a substantive rule requiring basis consistency that is set forth in IRC § 1014(f); and (2) reporting requirements imposed upon executors and certain other persons under IRC § 6035. The Highway Act also enacted

related penalty provisions under IRC §§ 6662, 6721 and 6722. Congress left it to the U.S. Department of Treasury and the Internal Revenue Service (IRS) to figure out how to implement these rules, and originally gave the IRS just 30 days to do – until August 31, 2015. The IRS has now on three separate occasions issued notices postponing the filing deadlines, with the most recent such notice, Notice 2016-27, 2016-15 IRB 1, pushing back the filing deadline for the reporting form applicable here – IRS Form 8971 – until June 30, 2016.

On March 4, 2016 the IRS published proposed regulations under IRC §§ 1014(f) and 6035 that are summarized in this article. https://www.irs.gov/irb/2016-12_IRB/ar10.html The proposed regulations

request comments by June 2, 2016, and it is anticipated that a number of professional organizations will so oblige.

A. Consistency of basis with estate tax return

Proposed § 1.1014-10(a)(1) provides that a taxpayer’s initial basis in certain property acquired from a decedent may not exceed the “final value” of the property as that term is defined in § 1.1014-10(c). This limitation applies to the property whenever the taxpayer reports to the IRS a taxable event with respect to the property (for example, depreciation or amortization) and continues to apply until the property is sold, exchanged, or otherwise disposed of in one or more transactions that result in

the recognition of gain or loss for Federal income tax purposes. The property for this purpose includes any other property the basis of which is determined in whole or in part by reference to the basis of the property acquired from the estate or as a result of the death of the decedent (for example, as a result of a like-kind exchange or involuntary conversion).

B. Property that increases estate tax liability

The consistent basis requirement of IRC § 1014(f)(1) applies only to property the inclusion of which in the decedent's gross estate for Federal estate tax purposes increases the Federal estate tax liability payable by the decedent's estate. Proposed § 1.1014-10(b) defines this property as property includible in the gross estate under IRC § 2031, as well as property subject to tax under IRC § 2106, that generates a Federal estate tax liability in excess of allowable credits. The proposed regulations specifically exclude all property reported on a Federal estate tax return required to be filed by IRC § 6018 if no Federal estate tax is imposed upon the estate

due to allowable credits (other than a credit for a prepayment of that tax). In cases where Federal estate tax is imposed on the estate, the proposed regulations exclude property that qualifies for a charitable or marital deduction under IRC §§ 2055, 2056, or 2056A because this property does not increase the Federal estate tax liability. In addition, the proposed regulations exclude any tangible personal property for which an appraisal is not required under Treas. Reg. § 20.2031-6(b) (relating to the valuation of certain household and personal effects) because of its value (generally there is a \$ 3,000 cutoff). Thus, if any Federal estate tax liability is incurred, all of the property in the gross estate (other than that described in the preceding two sentences) is deemed to increase the Federal estate tax liability and is subject to the consistency requirement of IRC § 1014(f).

C. Final value of property acquired from a decedent

IRC § 1014(f)(3) provides that, for purposes of IRC § 1014(f)(1), the "final value" of property has been determined for

Federal estate tax purposes if: (A) the value is reported on a Federal estate tax return filed with the IRS and is not contested by the IRS before the period of limitation on assessment expires; (B) the value is specified by the IRS and is not timely contested by the executor of the estate; or (C) the value is determined by a court or pursuant to a settlement agreement with the IRS.

Proposed § 1.1014-10(c)(1) defines the "final value" of property that is reported on a Federal estate tax return filed with the IRS. That value is the value reported on the Federal estate tax return once the period of limitations on assessment for adjusting or contesting that value has expired. If the IRS determines a value different from the value reported, the final value is the value determined by the IRS once that value can no longer be contested by the estate. If the value determined or specified by the IRS is timely contested by the estate, the final value is the value determined in an agreement that is binding on all parties, or the value determined by a court once the court's determination is final.

Proposed § 1.1014-10(c)(2) provides that the recipient of property to which the consistency requirement applies may not claim a basis in excess of the value reported on the statement required to be furnished under IRC § 6035(a) (the value shown on the Federal estate tax return) if the taxpayer's basis in the property is relevant for any purpose under the Internal Revenue Code before the final value of that property has been determined under proposed § 1.1014-10(c)(1). However, under IRC § 1014(f)(1), basis cannot exceed the property's final value. Therefore, proposed § 1.1014-10(c)(2) provides that, if the final value is determined before the period of limitation on assessment expires for any Federal income tax return of the recipient on which the taxpayer's basis is relevant and the final value differs from the initial basis claimed with respect to that return, a deficiency and an underpayment may result.

D. After-discovered or omitted property

The proposed regulations clarify how the consistent basis requirement applies

to property that is discovered after the filing of the Federal estate tax return or is otherwise omitted from that return. If this property would have generated a Federal estate tax liability if it had been reported on the Federal estate tax return that was filed with the IRS, proposed § 1.1014-10(c)(3)(i) provides two different results based upon whether the period of limitation on assessment has expired for the Federal estate tax imposed on the estate. Proposed § 1.1014-10(c)(3)(i)(A) provides that, if the executor reports the after-discovered or omitted property on an estate tax return filed before the expiration of the period of limitation on assessment of the estate tax, the final value of the property is determined under proposed § 1.1014-10(c)(1) or (2), as described above. Alternatively, proposed § 1.1014-10(c)(3)(i)(B) provides that, if the after-discovered or omitted property is not reported before the period of limitation on assessment expires, the final value of the after-discovered or omitted property is zero.

Finally, to address situations in which no Federal estate tax return

was filed, proposed § 1.1014-10(c)(3)(ii) provides that the final value of all property includible in the gross estate subject to the consistent basis requirement is zero until the final value is determined under proposed § 1.1014-10(c)(1) or (2).

E. Definition of executor for purposes of IRC §§ 1014(f) and 6035

The proposed regulations adopt the definition of the term "executor" found in IRC § 2203 applicable for Federal estate tax purposes and expand it to include a person required to file a return under IRC § 6018(b).

F. Requirement to provide Information Return and Statement(s) under IRC § 6035

The proposed regulations define the term "Information Return" as the Form 9971, "Information Regarding Beneficiaries Acquiring Property from a Decedent," including the "Statement" ("Schedule A") to be provided to each person who has received or will receive property from

the estate or by reason of the decedent's death.

Proposed § 1.6035-1(a)(1) provides that an executor who is required to file a Federal estate tax return also is required to file the Form 8971 with the IRS to report the final value of certain property, the recipient of that property, and other information prescribed by the Form 8971 and the related instructions. The executor also is required to furnish a Schedule A to each beneficiary who has acquired (or will acquire) property from the decedent or by reason of the death of the decedent to report the property the beneficiary has acquired (or will acquire) and the final value of that property.

G. Circumstances under which no Form 8971 or Schedule A is required under IRC § 6035

The proposed regulations provide that the filing requirements of IRC § 6035 do *not* apply where the executor is not required to file an estate tax return by IRC § 6018. Thus, proposed § 1.6035-1(a)(2) clarifies that the Form 8971 does *not* have to be filed where an estate tax

return is filed solely to make a portability election under IRC § 2010(c)(5), or a generation-skipping transfer tax election or exemption allocation, where a Federal estate tax return is not otherwise required to be filed under IRC § 6018.

H. Property to be reported on the Form 8971 and Schedule A

Proposed § 1.6035-1(b) defines the property to be reported on the Form 8971 and Schedule A as all property included in the gross estate for Federal estate tax purposes with four exceptions:

1. Cash (other than coins or papers bills with numismatic value);
2. Income in respect of a decedent (*e.g.*, qualified retirement plans and individual retirement accounts);
3. Those items of tangible personal property for which an appraisal is not required under Treas. Reg. § 20.2031-6(b); and
4. 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. *An open question here is what happens if property is sold at a fair market value that is precisely equal to basis so that no gain or loss results. This could very easily occur if property is sold soon after the decedent's death because of the step-up in basis to fair market value upon death. In the author's view, the proposed regulations should be modified to extend the fourth exception to cover this situation as well.*

I. Beneficiaries

Proposed § 1.6035-1(c)(1) provides that each beneficiary (including a beneficiary who is also the executor of the estate) who receives property to be reported on the estate's Form 8971 must receive a copy of the Schedule A reporting the property distributable to that beneficiary. Proposed § 1.6035-1(c)(2) provides that, if the beneficiary is a trust, estate, or business entity instead of an individual, the executor is to furnish the entity's

Schedule A to the trustee, executor, or to the business entity itself, and not to the beneficiaries of the trust or estate or the owners of the business entity.

Commenters to an earlier IRS Notice requested guidance on how to comply with the IRC § 6035 reporting requirements when the executor cannot determine the exact distribution of the estate's property and thus the beneficiary of each property by the due date of the Form 8971 and the related Schedule A's. This situation can arise, for example, when tangible personal property defined in Treas. Reg. § 20.2031-6 is to be distributed among a group of beneficiaries as that group determines, the residuary estate is distributable to multiple beneficiaries, or when multiple residuary trusts are to be funded. In response, proposed § 1.6035-1(c)(3) provides that, if by the due date the executor does not yet know what property will be used to satisfy the interest of each beneficiary, the executor is required to report on the Schedule A for each beneficiary *all of the property that could be used to satisfy that beneficiary's interest*. This results in the

duplicate reporting of those assets on multiple Schedule A's, but each beneficiary will have been advised of the final value of each property that may be received by that beneficiary and therefore will be able to comply with the basis consistency requirement, if applicable. Once the exact distribution has been determined, the executor may, *but is not required to*, file and furnish a supplemental Form 8971 and Schedule A.

Proposed § 1.6035-1(c)(4) provides that, if the executor is unable to locate a beneficiary by the due date of the Form 8971, the executor is required to report that on that Form 8971 and explain the efforts taken to locate the beneficiary. If the executor subsequently locates the beneficiary, the executor is required to furnish the beneficiary with a Schedule A and file a supplemental Form 8971 with the IRS within 30 days of locating the beneficiary. If the executor is unable to locate a beneficiary and distributes the property to a different beneficiary who was not identified in the Form 8971 as the recipient of that property, the executor is required to file

a supplemental Form 8971 with the IRS and furnish the successor beneficiary with a Schedule A within 30 days after distributing the property.

J. Due Date for Information Return and Statements

Proposed § 1.6035-1(d)(1) provides that the executor is required to file the Form 8971 with the IRS, and is required to furnish each beneficiary with that beneficiary's Schedule A, on or before the *earlier of* the date that is 30 days after the due date of the Federal estate tax return (including extensions actually granted, if any), or the date that is 30 days after the date on which that return is filed with the IRS. Proposed § 1.6035-1(d)(2) provides a transition rule for any Federal estate tax return that was due on or before July 31, 2015, but that is filed after July 31, 2015. In that case, the due date of the Form 8971 and all Schedule A's is 30 days after the date on which the estate tax return is filed.

K. Supplemental Form 8971's and Schedule A's

Proposed § 1.6035-1(e)(1) and (2) generally requires a supplemental Form 8971

and corresponding supplemental Schedule A upon a change to the information required to be reported on the Form 8971 or the Schedule A that causes the information as reported to be incorrect or incomplete. Such changes include, for example:

- the discovery of property that should have been, but was not, reported on the Federal estate tax return;
- a change in the value of property pursuant to an examination or litigation; or
- except as provided in proposed § 1.6035-1(e)(3)(B), a change in the identity of the beneficiary to whom the property is to be distributed (for example, as a result of death, disclaimer, bankruptcy, or otherwise).

Proposed § 1.6035-1(e)(3) provides that a supplemental Form 8971 and Schedule A may be filed -- *although they are not required* -- to correct an inconsequential error or omission within the meaning of Treas. Reg. § 301.6722-1(b) or to specify the actual distribution of assets previously reported

as being available to satisfy the interests of multiple beneficiaries in the situation described in proposed § 1.6035-1(c)(3), as described above.

Proposed § 1.6035-1(e)(4) provides that the due date for the supplemental Form 8971 and each supplemental Schedule A is 30 days after:

- (1) The final value (within the meaning of proposed § 1.1014-10(c)(1)) of property is determined;
- (2) The executor discovers that the information reported on the Form 8971 or Schedule A is otherwise incorrect or incomplete; or
- (3) A supplemental Federal estate tax return is filed.

However, if these events occur prior to the distribution to the beneficiary of probate property or of the property of a revocable trust, a supplemental Form 8971 or Schedule A is not due until 30 days after the property is distributed. The preamble to the proposed regulations express the belief that this is likely to be approximately the same time when the executor would provide the

beneficiary with information as to changes, if any, to the basis of the property that have occurred since the decedent's death and prior to the distribution. Because that basis adjustment is not part of what is required to be reported under IRC § 6035, however, if the executor chooses to provide that basis adjustment information on the Schedule A provided to the beneficiary, the basis adjustment information must be shown separately from the final value required to be reported on the beneficiary's Schedule A.

L. Subsequent Transfers

IRC § 6035(a)(2) imposes a reporting requirement on the executor of the decedent's estate and on any other person required to file an estate tax return under IRC § 6018. The purpose of this reporting is to enable the IRS to monitor whether the basis claimed by an owner of the property is properly based on the final value of that property for estate tax purposes. According to the preamble to the proposed regulations, the Treasury Department and the IRS are concerned that

opportunities may exist in some circumstances for the recipient of such reporting to circumvent the purpose of the statute. The preamble cites as an example the making of a gift of the property to a complex trust for the benefit of the transferor's family.

Relying upon the regulatory authority granted to Treasury by IRC § 6035(b)(2), the proposed regulations require additional information reporting by certain subsequent transferors in limited circumstances. Specifically, proposed § 1.6035-1(f) provides that, with regard to property that previously was reported or is required to be reported on a Schedule A furnished to a recipient, when the recipient distributes or transfers (by gift or otherwise) all or any 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 Schedule A documenting the new ownership of this property. This proposed reporting requirement is imposed on each such recipient of the property. For purposes of this provision, a related transferee means any member of the transferor's family as defined in IRC § 2704(c)(2), any controlled entity (meaning here a corporation or any other entity in which the transferor and members of the transferor's family, whether directly or indirectly, have control within the meaning of IRC § 2701(b)(2)(A) or (B), *and any trust of which the transferor is a deemed owner for income tax purposes*. This last prong would appear to apply to a transfer by a transferor to his or her revocable living trust that is an incomplete gift for gift tax purposes. *In the author's view, the proposed regulations should be modified to exclude a transfer to a trust of which the transferor is a deemed owner for income tax purposes where such transfer is an incomplete gift for gift tax purposes.*

In the event such transfer occurs before a final value

is determined within the meaning of proposed § 1.1014-10(c), the transferor must provide the executor with a copy of the supplemental Schedule A filed with the IRS and furnished to the transferee reporting the new ownership of the property. When a final value is determined, the executor will then provide a supplemental Schedule A to the new transferee instead of to the transferor. The supplemental Schedule A is due no later than 30 days after the transferor distributes or transfers all or a portion of the property to the transferee.

M. Proposed Effective / Applicability Date

Once the proposed regulations are finalized, they will apply to property acquired from a decedent or by reason of the death of a decedent whose estate tax return required by IRC § 6018 is filed after July 31, 2015. Taxpayers may rely upon these rules before the date of publication of the Treasury Decision adopting these rules as final in the Federal Register.

¹ ©2016 Kevin Matz. All rights reserved. Mr. Matz is the managing attorney of the law firm of Kevin Matz & Associates PLLC, with offices in New York City and White Plains, New York. His practice is devoted principally to domestic and international estate and tax planning and he is a Fellow of the American College of Trust and Estate Counsel (*ACTEC*). Mr. Matz is also a certified public accountant (in which connection he is a past chairman of the Estate Planning Committee of the New York State Society of Certified Public Accountants), and writes and lectures frequently on estate and tax planning topics. He can be reached by email at kmatz@kmatzlaw.com, or by phone at 914-682-6884.