estate planning briefs®

MAY 2016

Consistent basis rules take shape

On July 31, 2015, the President signed into law the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015. One minor component of the legislation implemented an idea that had been included in the President's earlier budget messages: requiring consistent basis reporting for income and estate tax purposes. To this end, executors of estates large enough to be required to file a federal estate tax return will have additional paperwork requirements. They have to inform both the IRS and beneficiaries of the tax basis of all bequests.

The law requires such filing within 30 days of the due date for the estate tax filing or 30 days after the actual filing. There was no transition rule, so the IRS created one with Notice 2015-57, 2015-36 IRB 294, which provided that no such filings would be due before February 29, 2016. Next the IRS further extended the deadline to March 31, 2016. Proposed Regs. had not yet been issued, and the Service suggested that executors wait for the Regs. before filing.

Temporary Regulations (T.D. 9757) were published codifying the delayed deadline to March 31, with an effective date of March 4, 2016. The deadline has since been extended to June 30, 2016.

On the same day that the temporary Regs. on the transition rule were published, the IRS issued the anxiously awaited Proposed Regs. on consistent basis reporting. The new rules apply only to property that increases the federal estate tax obligation. The proposed Regs. confirm that property that qualifies for the marital or charitable estate tax deduction is exempt from basis reporting, because it does not generate a federal estate tax obligation. They also make clear that when an estate tax return is filed simply to elect portability of the federal exempt amount between spouses, the new basis reporting similarly will not come into play.

The Regs. cover the situation in which additional estate property is discovered after the time for submitting basis reports, as well as the application of the rules to property that is sold during the period of estate administration. If assets discovered after an estate tax return has been filed are not reported to the IRS on a supplemental return, the basis of those after-discovered assets will be zero. That could lead to substantial capital gains exposure for heirs.

One area of potential controversy concerns reporting of subsequent transfers. In order to have complete monitoring of consis-

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tent basis compliance, the Proposed Regs. require the reporting of subsequent related-party transfers, as well as providing to transferees the basis information. At least one commenter has objected that such reporting requirements are beyond the scope of the law.

Comments on the Proposed Regs. are due by June 2, 2016.

—Notice 2016-27; 2016-15 IRB 576
—Reg-127923-15

COMMENT: According to the preamble to the newly proposed Regs. on consistent basis reporting, only about 10,000 taxpayers are expected to be affected by the information reporting per year. According to the analysis by the Joint Committee on Taxation (JCX-105-15) of the fiscal effects of the new law, the change will raise $117 million this year alone. That comes to $11,700 for every taxable estate, a remarkable level of tax noncompliance if true. The increased revenue grows each year, reaching $173 million in 2025, according to the JCT.

Executor not liable for unpaid estate tax

At the time of his death, Melvin Sacks was legally married to Alvia Sacks but had been estranged from her for 25 years. His "longtime companion" was Lucille Atwell, with whom he jointly owned a brokerage account worth some $2 million. Atwell was the beneficiary of Sacks' life insurance policies. Sacks also had a relationship with Joan Parker, with whom he jointly owned a residence in Bayside, New York. The property was purchased in July 1990, for $500,000, and Sacks provided the entire purchase price. He died the next month.

Sacks died with a substantial unpaid income tax from various years in the 1980s and 1990, well over $1 million. As there were limited assets in the probate estate, the executor obtained a restraining order over the brokerage account. In March 1991 he also disaffirmed transfer of the residence to Parker. In November 1991 an estate tax return was filed reporting a taxable estate of $3,208,103 and an estate tax liability of $1,011,279. No taxes were paid at that time. In 1994 the IRS assessed an estate tax deficiency of $831,313.

The income tax problem was resolved in December 1994, when the IRS accepted the executor's offer in compromise to pay $1 million to cover tax years from 1978 through 1990. The Surrogate's Court authorized a release from the brokerage account, $1 million for the IRS and $28,000 to pay executor's fees.

In 1997 Parker contributed $87,500 to the estate to pay her share of the estate taxes, and two grandchildren contributed $25,000 each. These amounts were forwarded to the IRS, but even so in February 1999 the outstanding amount due was more than $3 million, including interest and penalties.

The executor asked the Surrogate's Court in April 1999 to release additional funds from the brokerage account: (1) $251,107 to the Estate of Alvia Sacks; (2) $446,772 to the IRS; and (3) $171,587 to the New York Department of Taxation. These amounts were paid. The IRS believed that payment to anyone other than itself was improper and so issued a notice of fiduciary liability for $422,694 to the executor.

The personal representative of an estate is personally liable for the unpaid claims of the United States to the extent of a distribution, "if the Government establishes the following: (1) The personal representative distributed assets of the estate; (2) the distribution rendered the estate insolvent; and (3) the distribution took place after the personal representative had notice of the Government's claim" [*Allen v. Commissioner,* T.C. Memo. 1999-385]. The Tax Court held that the Sacks estate was not insolvent at the time of the distribution, because it continued to have claims against the transferees of nonprobate property for contributions to pay the estate tax. Therefore, the executor was not personally liable for the tax.

—Singer v. Comm'r, T.C. Memo. 2016-48

COMMENT: This decision was released March 14, 2016, some 26 years after Sacks' death. The case is not yet fully resolved.

Gift tax return errors may not extend statute of limitations.

Taxpayer made a substantial taxable gift in Year 1, but never filed a gift tax return. The IRS can assess a gift tax at any time, in any subsequent year, because the statute of limitations never begins to run. Sumner Redstone recently learned this lesson the hard way, when he had to pay a gift tax on a transfer made 40 years earlier. Normally, the IRS has only three years in which to challenge a gift tax return.

Now say that in Year 2 Taxpayer reported a large taxable gift. In calculating the amount of gift tax due, he omitted the Year 1 transfers and, therefore, paid less gift tax than he should have. Is that a substantial omission, which would double the limitations period to six years? It is not, the IRS ruled recently. The substantial omission must be with respect to transfers made for the period covered by the gift tax return. It would take a legislative fix to close this gap, the IRS concluded.

—ECC 201614036

Interest not waived in settlement

When he was 93, Anthony La Sala created ALS Family LLC to own and manage his wealth. He sold a 99% interest in the company to his daughter when he was 95 for a lifetime annuity of $913,986. In the exchange, the retained 1% was valued at $28,100, and the 99% at $2,781,900. The figures were arrived at by applying discounts to some of the fractional shares of closely held companies owned by ALSF. Anthony died after receiving one annuity payment.

On the estate tax return, the sale was treated as bona fide, so only the retained 1% was listed as an asset. The IRS felt that the discounts were too high, which meant that Anthony had overpaid for his annuity, and the Service also wanted to include the entire value of ALSF in the taxable estate under IRC §2036. The estate took the matter to the Tax Court, but a settlement was reached before trial began. The estate conceded that the discounts were too high, and the IRS conceded the legitimacy of the sale of the annuity. The excess value would be a taxable gift to the daughter. However, the stipulations did not identify the correct discounts or the amount of the taxable gift.

There was a change of personnel at the IRS, and negotiations resumed to finalize the numbers. Ultimately, the estate conceded a taxable gift of more than $1 million, triggering a gift tax of $235,207, and an estate tax obligation of $160,176. The executed decision document was silent on the matter of interest. Gift and estate tax returns were filed. On November 15 the estate sent the IRS a check for $230,838, covering the estate tax and interest. On November 18 a check was sent for the full amount of the gift tax, but without interest.

When the IRS processed the gift tax payment in January 2011, a late filing penalty of $52,922 was imposed; a late payment penalty of $58,802 was applied; and total interest due of $137,752 was calculated. A notice was sent to the executors, who no doubt thought that the IRS was reneging on their compromise. The estate asked for a hearing. The settlement officer abated the late filing and late payment penalties, and the interest on them, but refused to abate the interest on the gift tax itself.

The estate argued before the Tax Court that the amount of the gift tax was simply a "notational amount" that had been used in the settlement negotiations, and the gift tax return was filed at the request of the IRS to create an account to which the payment could be posted. As such, no interest should be required. The Tax Court was not convinced. By filing the gift tax return, the estate conceded that a taxable gift had taken place on a specific date, which created a due date for payment of the gift and the date for statutory interest to begin to run. The settlement officer did not abuse her discretion in making this determination.

—Estate of Anthony La Sala v. Comm'r,
T.C. Memo. 2016-42

COMMENT: The estate also contended that upholding its liability for interest on the 2003 gift tax would be inequitable because it was now prevented by the statute of limitations from claiming a deduction for that interest against the estate tax. Although the Court had some sympathy for the estate's position, it held that the responsibility for claiming deductions lies with the taxpayer.

Portability extension

Decedent died after the creation of the Deceased Spouse's Unused Exemption amount in 2010. How long after is not specified. Because the sum of Decedent's taxable gifts and estate assets was less than the federal exemption amount in the year of death, no estate tax return was filed. However, not filing a return also meant that the DSUE election was not made.

The oversight has now been discovered, and the executors have requested an extension of time to file the return and make the election. The IRS granted the extension, but included this warning: "If it is later determined that, based on the value of the gross estate and taking into account any taxable gifts, Decedent's estate is required to file an estate tax return pursuant to § 6018(a), the Commissioner is without authority under § 301.9100-3 to grant to Decedent's estate an extension of time to elect portability and the grant of the extension referred to in this letter is deemed null and void."

—Private Letter Ruling 201615010