NAVIGATING THE CURVES AND POTHOLES ON THE HIGHWAY TO BASIS CONSISTENCY

Lora G. Davis
Davis Stephenson, PLLC
100 Crescent Court, Suite 440
Dallas, Texas 75201
214.396.8800
lora@davistephenson.com
www.davistephenson.com

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Lora G. Davis

Davis Stephenson, PLLC

100 Crescent Court, Suite 440
Dallas, Texas 75201

214.396.8800
lora@davisstephenson.com
www.davisstephenson.com

Lora is a founding member of Davis Stephenson, PLLC. She focuses her practice on providing extensive estate planning services for individuals and multi-generational families of substantial wealth. Ms. Davis assists in implementing strategies that will preserve, protect, and transfer assets consistent with each client's customized plan. While working with clients to create comprehensive legacy plans, her focus is not limited to the tax planning aspects. She addresses family dynamics and core values, charitable legacy planning, and the emotional aspects of estate planning. Her experience includes preparing a wide variety of estate planning documents, handling issues involving the Internal Revenue Service, and assisting clients with charitable planning, probate matters, trust modification and reformation, the creation and administration of business entities, transfer tax planning and marital property issues.

Prior to starting the firm, Ms. Davis was with a large international law firm in Dallas, Texas, and also served as clerk to the Hon. Robert C. McGuire, Chief Judge of the U.S. Bankruptcy Court, Dallas. Before entering the practice of law, Ms. Davis served as controller for a privately-held company and was a tax consultant with Ernst & Whinney in Oklahoma City.

Ms. Davis is admitted to practice in Texas, is Board Certified in Estate Planning and Probate Law by the Texas Board of Legal Specialization, and is a licensed CPA in Oklahoma and Texas. She is a Fellow of the American College of Trust and Estate Counsel, serving as the Chair of the Fiduciary Income Tax Committee and a member of the Business Planning Committee and the Sponsorship Committee. She is the Secretary of the State Bar of Texas Tax Section, Council Member of the Real Estate, Probate, and Trust Law Section and Chair of that Section's Powers of Attorney and Advance Directives Committee. She is also the immediate past Chair of the Dallas Bar Association Probate, Trusts and Estates Section. Lora is active in numerous professional organizations and is a frequent speaker on trust, tax and estate planning topics.

She has been recognized by her peers as one of the Best Lawyers in Dallas in the area of Trusts & Estates as published by *D Magazine*, by Thomson Reuters' *Super Lawyers Magazine* as a Texas Super Lawyer, by *Texas Monthly* as a Five Star Professional Estate Planning Attorney in Dallas, and in Best Lawyers in America, Trusts and Estates. Since 2016, Lora has been selected by her peers to the Top 50 Women Lawyers in Texas and to the Top 100 Lawyers in Dallas/Ft. Worth lists, and since 2017 has been recognized as a Top 100 Lawyer in Texas (as compiled by Thompson Reuters, Inc. and published in Texas Monthly Magazine).

I. Introduction. In the heat of the summer of 2015, things were heating up in Congress as well, as legislators were diligently seeking funding sources to cover the expenditures in H.R. 3236, the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 (P.L. 114-41) (the "Act"). Flipping through the Administration's prior year versions of their tax policy "wish" book, also known as the "Greenbook" or the "General Explanation of the Administration's Fiscal Year Revenue Proposals," you may have noticed that a provision relating to requiring consistency in value for transfer and income tax purposes has been included ever since the fiscal year 2010 Greenbook (published May 11, 2009). This initial proposal included a basis consistency requirement not only for estate beneficiaries, but also for recipients of lifetime gifts. For the years 2010-2019, the proposed revenue from closing this loophole was projected to be $1.870 Billion. In the following years, this estimate increased to $2.103 Billion (for 2011-2020), $2.953 Billion (for 2012-2021), $2.014 Billion (for 2013-2022), $1.896 Billion (for 2014-2023), $2.501 Billion (for 2015-2024), and finally, an astounding $3.237 Billion (for 2016-2025). The 2017 Greenbook (published February 2016), while giving a nod to the new law, points out that there is still more money to be found and recommends broadening the scope of the basis consistency requirement so that property qualifying for the estate tax marital deduction (in estates that exceed the filing threshold, which is $5,450,000 for 2016, $5,490,000 for 2017, and $5,600,000 for 2018) and property transferred by gift (if the gift is required to be reported on a federal gift tax return) would be subject to these rules. The additional revenue projected for this broadening of the scope of the new law to include marital and lifetime gifts for 2017-2026 is $1.693 Billion. Doing some simple math, and assuming that marital gifts were not excluded in the prior estimates, it looks like we could get an additional extension of the basis consistency reporting requirements if there is some upcoming legislation that needs about $1.544 Billion in revenue.

There have not been any Greenbooks published under the new administration. A search of the President's budget webpage does not reveal any indication of the position the new administration is taking on basis consistency issues. The administration's first budget proposal called "A New Foundation For American Greatness, Fiscal Year 2018" was released on May 23, 2017. Included in this budget is the following statement: "Tax relief for American families, especially middle-income families, should … abolish the death tax, which penalizes farmers and small business owners who want to pass their family enterprises on to their children." Curiously, when you review the tables included as part of this budget, the line item income relating to estate and gift taxes doesn't change at all from the baseline numbers to the proposed budget by category numbers. This may reflect the reality that repeal of the estate tax, or "death" tax, is not something even the administration is counting on. However, on September 27, 2017, the White House and several Congressional Republican leaders released their plan for tax reform, entitled "Unified Framework for Fixing Our Broken Tax Code." Quite the catchy title! At seven pages long, it's not quite a tax plan that we can spend hours analyzing. With respect to "death" and generation-skipping transfer taxes, the framework calls for the repeal of each of them. With the enactment of the "Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018" (P.L. 115-97, often referred to as the Tax Cuts and Jobs Act or the 2017 Act), we are all well aware of the increase of the basic exclusion amount in 2018 to $10,000,000 adjusted for inflation ($11,200,000 in 2018 and $11,400,000 in 2019), sunsetting on December 31, 2025. Although not a repeal of the estate tax in a true sense, this doubling of the exclusion amount has the effect of a repeal for a vast majority of Americans. According to the Tax Policy Center of the Urban Institute & Brookings Institution, of the 4,000 estate returns that will be filed for decedents dying in 2018, only 1,900 will be taxable, which is less than 0.1% of the 2.7 million expected deaths in 2018.[1] Of course, with the current law scheduled to sunset back to the

[1] See the Tax Policy Center Website at https://www.taxpolicycenter.org/briefing-book/how-many-people-pay-estate-tax for more information.

$5,000,000 basic exclusion (as adjusted for inflation) beginning in 2026, we seem to be in a constant state of planning flux.

Presumably any repeal of the estate tax could potentially result in elimination of the basis consistency rules. However, as with gift taxes, there is no mention in the existing framework about basis issues and whether repeal of the estate tax would result in a continued reporting obligation in connection with basis consistency. It is not clear whether a crystal ball or a Magic 8 ball will be more helpful in knowing the answers. For now, we will continue down the highway, navigating the curves and dodging the current potholes, to get us to basis consistency under current law.

II. New Sections 1014(f) and 6035.[2] The Act was signed into law on July 31, 2015 and the basis consistency requirements are applicable "to property with respect to which an estate tax return is filed after [July 31, 2015]".[3] Two new provisions, §§ 1014(f) and 6035, were added to implement the new basis consistency rules for certain estates.

Section 1014(f) provides the basis consistency rule. The general rule under this new section provides that the initial basis of property acquired from a decedent cannot exceed the value as finally determined for estate tax purposes, or if not finally determined, then the value reported to the recipient on Schedule A to Form 8971. However, this general rule only applies to assets that result in an increase in estate tax. Thus, assets that qualify for the marital and charitable deduction are not subject to the basis consistency rules of § 1014(f).[4]

Section 6035 sets forth the reporting requirements that the executor of the estate must fulfill. In general, the executor of any estate that is required to file an estate tax return must prepare and file with the IRS a Form 8971 and a Schedule A for each beneficiary of the estate within 30 days following the due date (as extended) of the estate tax return.[5] A Schedule A must also be furnished to each beneficiary within this same timeframe. This section also provides for supplemental reporting in certain circumstances and penalties for failure to file. It is important to note that this section, unlike § 1014(f), does not have any exclusions that are based on the status of the recipient. This means that even though the recipient of assets that qualify for the marital or charitable deduction will not be bound to the basis consistency requirement, the executor will still need to report the estate tax value of those assets to both the IRS and the recipient. The specific requirements of Form 8971 and Schedule A are discussed in more detail below.

Also to note, and further evidence that the IRS must have some real concerns about being "whipsawed" by taxpayers on basis issues, two other changes were included in the Act relating to basis reporting issues. One change is an amendment to § 6501(e)(1)(B) to add a provision that states that an understatement of gross income due to an overstatement of basis is an omission from gross income for purposes of determining if a 6-year statute of limitations is applicable. The other addition affects the adequate disclosure rules. Section 6501(e)(1)(B)(iii) specifically provides that even if an overstated value is disclosed in a return in a manner adequate to apprise the IRS of the nature and amount of the overstatement, it will still be considered an amount omitted from gross income. This provision may give the IRS some time to go back and look at older returns that haven't made it to the six-year mark yet!

As to be expected with any completely new law, there are some glitches and hiccups in the application. We anticipate more guidance to come from the IRS after they review all of the comments

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[2] Unless otherwise indicated, references to "section" or "§" are to the Internal Revenue Code of 1986, as amended, and all references to 'regulation," "proposed regulation" or "Prop. Reg. §" are to the regulations or the proposed regulations, as the case may be, promulgated thereunder.
[3] H.R. 3236, § 2004(d).
[4] In addition, certain items of tangible personal property are not subject to the basis consistency rules of § 1014(f). This exception to the rule is discussed in more detail below under section labeled "WHAT."
[5] The proposed regulations use the term "information return" to refer to Form 8971 and Schedule(s) A that are provided to the IRS and "statement" to refer the Schedule A provided to a beneficiary of an estate. Prop. Reg. § 1.6035-1(g).

they receive on the proposed regulations. The IRS held a public hearing on June 27, 2016 on the proposed regulations. Four people gave testimony in that hearing. Until more guidance is received, we will have to play by the rules that we have been given.

III. Form 8971 and Schedule(s) A. Determining the appropriate reporting protocol, creating forms and setting up a process was no small task. With the effective date of the new law and the new filing requirements applying to returns filed after July 31, 2015, an executor who filed an estate tax return on August 1, 2015 would have needed to file Form 8971 and Schedule(s) A with the IRS and provide Schedule(s) A to the beneficiaries of the estate by August 31, 2015. The tricky part of that deadline was that there was no existing form for reporting created at that time! Realizing the difficulty in requiring compliance by the statutorily-created deadline, the IRS issued Notice 2015-57 on August 21, 2015 extending the deadline for all reporting under the new basis consistency rules to February 29, 2016.[6] On December 18, 2015, the IRS released a draft Form 8971 and Schedule A, without including any instructions. The draft instructions were later made available on January 5, 2016. After making their way through the Office of Management and Budget for review, both were posted to the IRS draft forms website with a January 26, 2016 date and were later added with minor changes to the current forms list with a January 2016 date. On February 11, 2016, the IRS issued a further extension of time to file and to furnish the statements to beneficiaries until March 31, 2016, indicating that the delay was intended to give executors the ability to review the soon-to-be-released proposed regulations.[7] Those proposed regulations were released on March 2, 2016[8] and were later finalized on December 1, 2017.[9] After being inundated with requests for a further delay to enable executors and their advisors time to review the regulations and the forms, the IRS issued Notice 2016-27[10] that provided another extension of time for filing Form 8971 and Schedule(s) A and furnishing the schedules to beneficiaries of the estate to June 30, 2016. The IRS provided for no further extensions, making all "extended" returns due on June 30, 2016. However, revised draft instructions were released on June 8, 2016. Those instructions were further revised and were subsequently released on October 13, 2016 as the current instructions, with a revision date of September 2016.

The June instructions specifically stated that no attachments should be added to Schedule A. This created quite a stir among estate tax return preparers. The IRS must have gotten an earful over it (and likely noncompliance to boot), as the current instructions no longer include the prohibition on attachments. The newest instructions, released with the date of September 2016, now provide that listings of "bulk assets" may be attached to Schedule A in lieu of replicating that information on the form. The attachment should include only the information relevant to basis reporting (e.g., description of property, value and valuation date). It is unclear if retaining additional information, such as the high/low values reported on many stock valuation programs, will be problematic. Including a property appraisal to Schedule A is specifically noted as something that you should not do. Additionally, the new instructions appear to provide some welcome relief with respect to obtaining beneficiaries taxpayer identification numbers. Generally, if the number has not been obtained, "requested" can be entered on the return, or if a foreign beneficiary is not required to provide one, "not required" can be entered. This should be welcome relief in certain situations, and is discussed in more detail below.

That gets us to the "who, what, when and where" of these new returns.

A. WHO? This is a three part question. First, we must determine who is required to initially report to the IRS and the beneficiaries. Next, we need to determine if an initial recipient of a Schedule A is subject to further reporting requirements in connection with a subsequent transfer of an asset

[6] Notice 2015-57, 2015-36 IRB 294 (Aug. 21, 2015).
[7] Notice 2016-19, 2016-9 IRB 362 (Feb. 11, 2016).
[8] T.D. 9757, 81 F. R. 11486 (Fed. Reg. Doc. 2016-04718 (Mar. 2, 2016)).
[9] T.D. 9797, 81 F. R. 86953 (Fed. Reg. Doc. 2016-28906 (Dec. 2, 2016)).
[10] Notice 2016-27, 2016-15 IRB 576 (Mar. 24, 2016).

reported on his or her Schedule A (which is discussed in detail below under the Subsequent Transfer Rule). Finally, we must determine which beneficiaries will receive a Schedule A.

1. Who has to initially report? Who needs to file a Form 8971 and the initial Schedule(s) A with the IRS and initially furnish a Schedule A to each beneficiary of the estate?

a) *Short Answer*: The executor of the estate.

b) *Detailed Answer*: Section 6035(a) provides that an executor of an estate or any other person who is required to file an estate tax return under § 6018 must file the return and furnish the statements.[11] Section 6018(a) provides that executors of estates of U.S. citizens or residents that have a gross estate value that exceeds the basic exclusion amount ($11,400,000 in 2019) are required to file an estate tax return. In addition, a return will need to be filed for a nonresident non-citizen who has property located in the U.S. with a value that exceeds $60,000 (reduced by certain adjusted taxable gifts made during the decedent during life) under § 6018(a)(2) and (3). Section 6018(b) states that if an executor is not able to make a complete return for any reason, the executor must include a description of the property excluded from the return and the name of each person who holds any interest in the omitted property. Section 6018(b) goes on to provide that "[u]pon notice from the Secretary such person shall in like manner make a return as to such part of the gross estate." Further, an executor is defined to include "the executor or administrator of the decedent, or, if there is no executor or administrator appointed, qualified, and acting within the United States, then any person in actual or constructive possession of any property of the decedent."[12] Thus, in circumstances where no executor qualifies because the estate is held in a fully-funded revocable trust, the trustee of the revocable trust will be the "executor" who is required to file Form 8971 and Schedule(s) A with the IRS and furnish a Schedule A to each of the beneficiaries. Although most of the time the answer will likely be the acting executor, there may be instances where someone else entirely or in addition to the executor will be required to file and furnish these required forms. For ease of reading, the term "executor" will be used generically to refer to the person required to initially report to the IRS and the beneficiaries.

Proposed regulation § 1.6035-1(a)(2) clarifies that there is no requirement to file Form 8971 and Schedule(s) A with the IRS or furnish a Schedule A to the beneficiaries of the estate if the estate tax return is not required to be filed under § 6018 but is filed in any event by the executor. Examples listed in the proposed regulations for filing a return for a nontaxable estate include to make a portability election, to make a generation-skipping transfer tax election or exemption allocation, or to file a return for a nontaxable estate to avoid a potential penalty in cases where an increase in an asset value would result in a filing requirement. These examples are not exclusive, so as long as the executor is not required to file a return under § 6018, there is no filing/furnishing requirement.

2. Who receives an initial Schedule A? Once the person tasked with filing with the IRS and giving the beneficiaries notice is determined, that person needs to figure out who should receive an initial Schedule A.

a) *Short Answer*: Each beneficiary who receives property that is included (or required to be included) on an estate tax return that is required to be filed, subject to exceptions for certain assets.

[11] See also Prop. Reg. §1.6035-1(g)(1).
[12] §2203.

b) *Detailed Answer*: As mentioned above, even though the basis consistency rules do not apply to surviving spouses who receive property that qualifies for the marital deduction or to charitable organizations that receive property that qualifies for the charitable deduction, those individuals and organizations are not exempt from the reporting rules under § 6035. The proposed regulations also provide some additional guidance on this subject. The executor must furnish Schedule A to each beneficiary who receives an asset that is reported on the information return.[13] If the executor is also a beneficiary of the estate, he or she is explicitly required to furnish Schedule A to himself or herself.[14] In cases of a life estate created under the estate, both the life tenant and the remainder beneficiaries must receive a Schedule A as to each of their respective interests.[15] The remainder beneficiaries are those who would take if the life tenant died immediately following the decedent.[16] If the beneficiary is a trust or an estate, the Schedule A will go to the trustee or the executor, as the case may be, and presumably not to the beneficiaries of the trust or the estate.[17] If the beneficiary is an entity, Schedule A is provided to the entity.[18]

There may be situations in which the identity of a beneficiary cannot be determined. In those cases, proposed regulation § 1.6035-1(c)(4) states that "an executor must use reasonable due diligence to identify and locate all beneficiaries." If unable to locate a beneficiary, the executor must provide all relevant details of Form 8971 and provide an explanation of the steps taken to locate the beneficiary. There is no guidance given if the executor cannot identify a beneficiary. This could occur, for example, in the case of a legal dispute over the estate that makes it unclear who the proper beneficiary is under the will or in the event that there is a class of recipients that cannot be identified by the due date of the Schedule A, such as heirs-at-law. A logical application of the proposed regulations would be to apply the rules related to beneficiaries who cannot be located to any beneficiaries who cannot be identified. Note that upon locating a beneficiary that was not initially located, the executor will have a duty to provide Schedule A to the beneficiary 30 days after locating him, her or it, as discussed in more detail in the Supplemental Reporting section below.

As more fully discussed below in the "What" section, generally only the assets that (i) are reported on the estate tax return or are assets with a basis that is determined by reference to an asset reported on the estate tax return in whole or in part, and (ii) are distributed (or will be distributed) to a beneficiary are reported on Schedule A. So, whether or not a beneficiary of an estate actually will receive a Schedule A will depend on the administration of each estate. For example, if all of the assets of the estate are liquidated during the administration of the estate prior to the filing deadline for the estate tax return and the beneficiary does not receive any assets that were held in the estate on the date of death, no Schedule A will be required. Proposed regulation § 1.6035-1(b) provides for additional exceptions from the reporting requirements, which include cash, income in respect of a decedent, tangible personal property for which an appraisal is not required and certain property sold by the estate. These exceptions are discussed below in more detail. Thus, even though a beneficiary may be

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[13] Prop. Reg. §1.6035-1(c)(1). Keep in mind that, as noted above, the term "information return" include both the Form 8971 and Schedule(s)A attached to the Form 8971.
[14] *Id*.
[15] *Id*.
[16] *Id*.
[17] Prop. Reg. §1.6035-1(c)(2).
[18] *Id*.

the proper recipient of a Schedule A, there may be no assets to report on the Schedule A after all is said and done.

c) *Questions*: Following are a few questions that have arisen in working through the statute, the proposed regulations and the forms.

Who is included as a remainder beneficiary for reporting purposes? There appears to be a typo in the proposed regulations relating to the determination of remainder beneficiaries. It seems fairly clear that the Treasury and IRS left out the word "not" in this section. Below is the logical correction to proposed regulation § 1.6035-1(c)(1):

> For purposes of this provision, the beneficiary of a life estate is the life tenant, the beneficiary of a remainder interest is the remainderman(men) identified as if the life tenant were to die immediately after the decedent, and the beneficiary of a contingent interest is [**not**] a beneficiary, unless the contingency has occurred prior to the filing of the Form 8971.

Representatives from Treasury and the IRS have informally acknowledged this error, which they indicated will be corrected in the final regulations.[19] Although this acknowledgment does not bind the IRS and there is no certainty that inserting the word "not" will be the final correction, it is the most logical reading of the sentence in its entirety. For those who are facing the task of determining whether or not to provide a Schedule A to all potential remaindermen by including remote contingent beneficiaries, it will most likely be a matter of comparing the risks of under reporting (see the section on Penalties below) and over reporting (i.e., giving too much information to beneficiaries that creates confusion and possible agitation of beneficiaries) against the practical difficulty of identifying and providing notice to all potential beneficiaries.

Who gets Schedule A, the fiduciary or the beneficiary? The proposed regulations are fairly clear that notice should go to a fiduciary of a trust or estate instead of to the beneficiaries. However, professionals have queried whether this is the appropriate rule in all cases. For example, if a decedent had a will that left everything outright to her only child, the child would be the proper recipient of the Schedule A. However, if the same decedent had a will that left all of her property to a revocable trust, of which Trust Company A was the trustee, and the trust provided that on her death all assets would pass outright to her only child as the sole beneficiary, the trustee of the (terminating) revocable trust would be the proper recipient of the Schedule A. This outcome seems a bit nonsensical. In addition, there may be circumstances in which there is no current fiduciary serving at a time when notice is required to be given (e.g., due to the death or resignation of the trustee or executor). In these situations, it may make sense to give the executor the option to choose who the notice should be given to, the fiduciary or the actual beneficiaries. Until further guidance is provided, as long as there is a trustee who is able to accept the Schedule A, giving the notice to the trustee appears to be the prudent action to take. In cases where there is no trustee serving at the time that the Schedule A is due, a logical approach would be to use the method provided for unlocated beneficiaries by notifying the IRS of the situation on the timely-filed Form 8971 and later filing the Schedule A when a new trustee is appointed.

What if the executor cannot identify or locate a beneficiary timely? The guidance provided on how to meet the requirements of § 6035 in the case of missing

[19] Acknowledged by Cathy Hughes on May 7, 2016 at the ABA Tax Section Meeting during a presentation by Cathy Hughes (with Office of Tax Policy, Department of Treasury) and Theresa Melchiorre (Attorney with the Office of the Associate Chief Counsel (Passthroughs and Special Industries), IRS).

or unidentified beneficiaries needs to be expanded to cover circumstances under which the executor, despite reasonable due diligence, is unable to obtain sufficient information to file a complete Schedule A for other reasons. For example, sometimes the executor is unable to obtain an SSN or TIN from the beneficiary. While the executor may be able to withhold a distribution of the asset until the SSN or TIN is finally received, that date may be well after the due date of the Schedule A for that uncooperative beneficiary. There may be instances where the beneficiary does not have an SSN, TIN or an ITIN (which is provided to individuals who are not eligible to receive an SSN). This could occur with foreign beneficiaries. There will be many circumstances under which the executor will not have the ability to direct the foreign beneficiary to obtain an ITIN or the trustee of the trust to obtain a TIN. This issue also fairly often occurs when a trust is created under the will as a beneficiary, but because of the administration, the newly-created trust has not yet been funded and no TIN has been obtained.

If any of these circumstances arise with respect to a client that you are advising, it would be wise to exert all possible efforts to comply with the reporting requirements. Advance planning for these issues will be critical, so that you can document that the executor exercised due diligence in attempting to gather the information needed for the Schedule A. For example, if the executor is also the trustee of the trusts created under the will, it may make sense to distribute at least a minimal amount to the trusts in order to establish them for state law purposes so that the executor/trustee can get a TIN for the new trust. If the issue relates to uncooperative beneficiaries, the executor should start early and attempt often to get this information from the beneficiaries. All of these efforts should be documented, explicitly providing the number of times and the methods by which the executor attempted to obtain the needed information. If it is possible to withhold any distribution to the beneficiary pending the receipt of this information, that would be a prudent course to take as well. It would seem logical that as long as assets have not been distributed to a beneficiary, the failure to timely report the basis of those undistributed assets will not put the IRS at a disadvantage or thwart Congress's goal of basis consistency. Thus, a failure to timely report in a situation like this should not result in harsh penalties on the estate for being unable to comply with a provision that requires the cooperation of individuals over which the executor has no control. Admittedly, issues relating to a foreign beneficiary are a stickier wicket. If the situation is one in which the ITIN can be obtained by the beneficiary, the executor should request that the beneficiary take those steps. The IRS website indicates that it takes a minimum of 7 weeks for them to process a completed application for an ITIN, so this process should be started early.[20] If the foreign beneficiary fails to qualify or refuses to apply for an ITIN, the executor is again put in a nearly impossible situation. In those circumstances, resorting to the judicial system may be a possible resolution that would protect the executor.

The IRS did provide what appears to be additional relief in the September 2016 instructions to Form 8971 and Schedule A. Those instructions indicate that if the executor has requested the TIN of a beneficiary in writing and has not received it in time for the filing of the form, the executor should include "requested" in the space for the TIN and attach the written correspondence to Form 8971. In addition, if the executor determines that a foreign beneficiary of the estate is not required to provide a TIN to the estate, then the executor can include "not required" in the space for the TIN. This may give executors without other recourse some comfort, however, these

[20] A detailed review of the requirements for obtaining an ITIN are beyond the scope of this paper. See https://www.irs.gov/individuals/general-itin-information for information from the IRS.

instructions are not consistent with the proposed regulations and will not be binding on the IRS. Any and all suggestions for changes in this area (and any others) should continue to be passed along to the IRS.[21] For now, executors and their advisors will be tasked with finding their own way in these difficult situations.

B. WHAT? Now that we have determined who gives and gets the information, we need to determine what exactly needs to be reported on Schedule A. This is where things start to get a little murky. We will start with an overview of the general reporting rules for all estates subject to § 6035. After addressing the general rules, we will review the requirements for a supplemental reporting under § 6035(a)(3)(B) and proposed regulation § 1.6035-1(e) ("Supplemental Reporting"). Finally, we will analyze when the new rule under proposed regulation § 1.6035-1(f) will require a recipient of an asset from an estate to report a subsequent transfer of that asset (the "Subsequent Transfer Rule"). Only Schedule A reporting requirements will be described in this section. The details relating to what information is reported on Form 8971 is discussed below in the section for "Completing the Forms."

1. General Reporting Rules for Schedule A. Schedule A is provided to both the IRS and each beneficiary receiving property from the estate that is reportable under the new rules. This schedule is intended to give the beneficiary notice of his or her initial basis in an asset, while giving the IRS a method for tracking that value in relation to each specific beneficiary. As discussed in more detail below, this reporting is generally due 30 days after the estate tax return is filed. Does every asset of the estate need to be reported on a schedule?

a) *Short Answer*: For Schedule(s) A, generally only the value of assets that (i) are reported on an estate tax return or are assets with a basis that is determined by reference to an asset reported on the estate tax return in whole or in part, and (ii) are distributed (or are anticipated to be distributed) to a beneficiary are reported. There are some exceptions to reporting, such as cash, items of income in respect of a decedent ("IRD"), tangible personal property items for which an appraisal is not required and property disposed of by the estate if capital gain or loss is recognized.

b) *Detailed Answer*: The requirement that the executor file a report with the IRS within 30 days following the estate tax return due date (or actual filing date, whichever is earlier) that lists all of the assets that the beneficiaries of the estate have received or will receive clearly does not take into account the fact that, in most estates, very few assets have been distributed by that time and decisions have not been made as to which specific assets the beneficiaries will receive. Indeed, most assets of an estate are typically retained by the executor of the estate until at least the closing of the estate for federal estate tax purposes, whether by audit or a closing letter.[22] A prudent executor will want to avoid the risk of distributing the estate before taxes are finally determined, in the event that those assets will be needed to pay any additional tax. In some cases, distributing those assets before a final tax determination could result in personal liability to the executor. It is apparent that the Treasury and IRS tried to make do with a law that was passed hurriedly by a legislature that is oblivious to these practical realities. However, the proposed solution to report anything the executor believes "could" be distributed to a beneficiary on Schedule A seems to be an ineffective approach to attaining the goal of getting "basis" information in the hands of the person who will need it for his or her own tax reporting purposes. Moreover, this requirement could result in a situation that is fraught with peril for an executor of an

[21] Comments on the proposed regulations can be submitted to the IRS electronically via the Federal eRulemaking Portal at http://www.regulations.gov.

[22] Although the IRS is no longer automatically issuing closing letters for estates, a closing letter can and should be requested for estates with a filing requirement.

estate with beneficiaries who are at odds with each other. It is not unusual for there to be personal issues among related beneficiaries that require careful attention from the executor. That delicate balance could easily be disturbed by this reporting burden that is placed on the executor. Executors who find themselves in this type of situation may want to take steps to ameliorate a potentially disastrous result.

Of course, the simplest approach will be to actually distribute assets prior to filing Schedule A. In some situations, that may be possible, such as when the surviving spouse is the sole beneficiary and the executor of the estate. Alternatively, reporting all of the assets as potential distributions to every beneficiary may not be as awkward in estates with a small number of assets or beneficiaries who all get along so that there will be no angst over any differences between the potential allocations reported and the actual distributions made. Some have suggested that, to the extent practical, a fiduciary should liquidate assets of the decedent following death to eliminate the reporting requirement all together. Alternatively, changing the form of the assets during estate administration has been proposed as a way to eliminate the reporting requirement. For example, the executor could sell a decedent's property to a new entity established by the beneficiaries and then make distributions of the entity interests to the beneficiaries. If the sale occurs very quickly following the death of the decedent, the potential for a gain or loss on the sale would be minimal. There are too many different possible scenarios to discuss in detail here, but it seems highly likely that there will be many cleverly designed techniques that will be implemented to reduce or even completely eliminate the reporting requirement under § 6035.

Proposed regulation § 1.6035-1(b) clarifies that the value of assets reported on an estate tax return, as well as any asset with a basis that is determined by reference to an asset reported on the estate tax return whether in whole or in part, must be reported on a Schedule A. It also clarifies that for a nonresident non-citizen decedent, only property that is subject to U. S. estate tax, and for community, only the decedent's one-half interest must be reported on the Schedule. In addition, it provides for some exceptions from reporting that are not found in the statute. Those exceptions include cash (but not coin collections or other currency with numismatic value), IRD, tangible personal property for which no appraisal is required under regulation § 20.2031-6(b) (i.e., assets without a value in excess of $3,000, which are also exempt from the basis consistency rules of § 1014), and property sold, exchanged or disposed of by the estate in a transaction in which "capital gain or loss" is recognized and that is not distributed to a beneficiary.[23] It is important to keep in mind that what is being reported is the <u>value</u> of the asset as reported on the estate tax return and not what might actually be the recipient's <u>basis</u> in the asset.

c) *<u>Questions</u>*: Following are several questions relating to the general reporting rules.

What counts as cash? Clearly the exception for cash applies to the cold, hard cash that the decedent has stashed in his wallet, under his mattress, in the cookie jar, and any other location. It also seems likely that this exception applies to cash held in all bank and brokerage accounts, certificates of deposit and other similar accounts. Equally likely, those types of accounts and actual cash that are held in a foreign currency should also be treated as cash. To the extent that life insurance proceeds are payable solely in cash, those proceeds should logically be treated as cash for Schedule A reporting purposes. Less clear examples of assets that are arguably equivalent to cash include notes receivable, accounts receivable and tax or other refunds that are valued

[23] Prop. Reg. §1.6035-1(b)(1).

on the estate tax return at their face amount. Until clarification is received on these issues, it may be prudent to err on the side of over reporting on Schedule A for some of these assets, such as insurance and receivables. Depending on the risk tolerance of the executor (which may correlate directly with the potential exposure to penalties), you may end up reporting everything but that cookie jar cash.

Questions about IRD. The term IRD generally means amounts that would be treated as gross income of the decedent if he or she had received them during life. Common examples include IRAs and 401(k) accounts. However, there are several types of assets that may include IRD that will also have a basis component. Examples include IRAs and 401(k) accounts established with after-tax contributions, certain Roth IRAs and Roth 401(k) accounts, nonqualified annuities, installment notes with basis and unrecognized gain, and an interest in a pass-through entity that holds inventory or unrealized receivables. It is not clear if these "hybrid" IRD assets fall under the exception for IRD. From a pure compliance perspective, it would seem that assets that have a basis component that are received from the decedent should not qualify for the exception. With that in mind, a conservative approach would be to report any hybrid assets on a Schedule A. Indeed, there is no IRS penalty for over reporting.

How does the tangible personal property exception work? This exception appears to be aimed at reducing the burden of reporting the value of the sheets and towels to the IRS and the beneficiaries of the estate. Unfortunately, the dollar amount of the exception is tied to a regulation that was written in 1958. Applying the U.S. Bureau of Labor Statistics CPI(U) Index, $3,000 in 1958 would be worth nearly $25,000 now. Regulation § 20.2031-6(a) provides the general rule for reporting household and personal items that don't individually exceed $3,000. It requires an itemized list, although items valued at $100 or less that are contained in the same room may be grouped together. The regulation indicates that a "room by room" itemized list is desirable. Based on informal surveys of colleagues, this room by room list is rarely (if ever) used, and most executors report this as one lump sum item for the whole house (taking care to get any one item valued at over $3,000 separately appraised, of course).[24] With the spotlight on this regulation, basis consistency, and initial basis reporting requirements, it is unclear whether our old ways of reporting will continue to be acceptable. I suspect that many practitioners, after reviewing this provision, will ask their executors to either obtain full appraisals that include room by room estimates of the items that are not individually appraised, or will ask the executor to separate out the estimated values of those sheets, towels and picture frames on a room by room basis. After all, with fewer returns being filed overall, you don't want to leave low-hanging fruit for the IRS to pick. This is an easy item to report in a manner that most closely reflects the desired reporting method. Unfortunately, the cost burden-benefit ratio often does not work to the executor's favor for this type of reporting.

Assuming that the executor does get an appraisal, you are not home free yet. Often, an appraiser will lump together like items in a group for valuation purposes. However, those items may ultimately be divided among beneficiaries of the estate based on their allocations or selections in satisfaction of their share of the tangible personal property of the decedent. It seems unlikely that the IRS expects the executor to specifically allocate value among the beneficiaries for these types of items. However, there is no direction currently under the regulations. A practical approach would be to provide the beneficiaries who receive a share of the tangible personal property with the

[24] Note that although the regulations seem to require that only single items valued at over $3,000 require further documentation, some collections, namely coin and stamp collections, are listed as well. See Treas. Reg. §20.2031-6(b).

value information on all of the appraised property so that each of them can allocate the value to the items he or she ultimately receives. However, if those assets are distributed prior to the filing of the Schedule A, the executor is technically obligated to only report to the beneficiary the assets that he or she actually received (and not those that others have received). Arguably, even if the assets have been distributed, there may be some reallocation among the beneficiaries. In larger estates, the listing of these types of assets seems to be disproportionally long. It would seem that any method used by the executor that gives the beneficiary and the IRS sufficient information to determine the basis of assets that were or may be distributed to a beneficiary would be acceptable. Items of this nature are less likely to be sold for a gain or a deductible loss and pose little risk of creating a whipsaw situation for the IRS. However, until further guidance is issued, it may be prudent to report these assets down to the last sofa (and the sock stuck in it) to the greatest extent possible.

Is the sale exception really only applicable if capital gain or loss is recognized by the estate? This helpful exception likely was intended to encompass any asset that is sold by the estate that does not result in a carryover basis in the property received in return (e.g., a like-kind exchange). Certainly there are other types of gains (e.g., § 1231 gains) and sometimes no gain or loss at all even if a disposition has occurred. There are also situations in which assets that are distributed to a beneficiary can trigger gain or loss to the estate, and in those circumstances, it seems like those assets should qualify for the sale exception as well. Unfortunately, the proposed regulations are relatively clear on this point and limit the exception to the sale of assets that result in capital gain or loss. So, for now, the prudent approach would be to report all assets at the value reported on the estate tax return even if that value may not accurately reflect the Schedule A recipient's basis in the asset due to a deemed recognition event or a sale in which capital gain or loss is not recognized.

Further, is the sale exception really only applicable if the property is not distributed to a beneficiary? In addition to the capital gain requirement, the proposed regulation excepting property disposed of by the executor from the reporting requirement also (parenthetically) explains that the exception only applies when property is "… therefore not distributed to a beneficiary…."[25] However, in some cases when property is distributed to a beneficiary from an estate gain or loss could be recognized by the estate. In those cases, under § 643(e) the beneficiary would take the estate's basis, adjusted for any gain or loss recognized. Consequently, giving the beneficiary a Schedule A with the estate tax value of the asset would make no sense at all and is likely to cause confusion. It appears that the parenthetic language was added for clarification purposes. Unfortunately, it creates more confusion instead. Hopefully this will be corrected in the final regulations so that the sale exception applies to any disposition of property that is reportable by the estate in which the recipient is not using the estate's basis, in whole or in part, to determine his or her own basis. Until there is clarification, it appears that the safest course for the executor to take is to report any assets distributed to the beneficiary from the estate that don't neatly fit into the capital gain or loss sale exception described above.

2. Supplemental Reporting. To ensure that the IRS (and each beneficiary) is apprised of any changes in reported values, there is a general duty imposed on the executor to supplement any prior reporting if changes occur after the initial Form 8971 and Schedule(s) A are filed. Does every change need to be reported?

[25] Prop. Reg. §1.6035-1(b)(1)(iv).

a) *Short Answer*: In general, the executor will be required to file a supplemental Form 8971 and Schedule(s) A with the IRS and provide the supplemental Schedule A to each affected beneficiary if there is a change in any of the information that was previously reported.[26] However, there is no requirement to supplement to correct "inconsequential" errors. In addition, there is no duty to supplement if the original Schedule A included assets that were not actually distributed to a beneficiary, as long as the assets that were distributed were included on the original Schedule A furnished to the beneficiary.

b) *Detailed Answer*: The IRS wants to know about any changes to the information that you provide on either Form 8971 or Schedule A that will affect their ability to implement their new basis consistency processing system. Any change or correction relating to the identity of the recipient or the reported value must be given to the IRS by filing a supplemental Form 8971 and Schedule(s) A. This includes any change that makes the originally reported information incorrect or incomplete. Examples provided in the proposed regulations include (i) discovery of assets that were not included on the estate tax return, (ii) changes in the value of assets reported pursuant to an IRS audit, litigation, or otherwise, (iii) a change in the identity of the recipient, and (iv) a disposition of an asset of the decedent by the executor that results in the basis of the new asset being determined with reference to the disposed asset (in whole or in part, such as a like-kind exchange or an involuntary conversion). For example, if values are changed on audit, the values as adjusted must be included on a supplemental Schedule A that is given to each affected beneficiary and filed with the IRS with a supplemental Form 8971.

There are only two exceptions to this general rule. One is the exception for any subsequent clarification of "who got what" once distributions have actually been made. As long as the asset that a beneficiary actually receives is properly reported on his or her Schedule A, there is no duty to supplement to specifically identify what he or she received. For example, if there are two beneficiaries of an estate and all assets of the estate were reported on each beneficiary's Schedule A, then no supplemental filing is required to report the specific items they each actually received on distribution. There is no prohibition on filing a supplemental return to do so, but it is not required. Presumably, because the IRS will have information on each asset on the Schedule A connected with the beneficiary, their system will work in cases with over reporting, even though they may likely have a lot of extra information that they will never need with respect to each beneficiary.

The other exception is for "inconsequential errors and omissions." These are defined in regulation § 301.6722-1(b) as "…any failure that cannot reasonably be expected to prevent or hinder the payee from timely receiving correct information and reporting it on his or her return or from otherwise putting the statement to its intended use." The regulations go on to give examples of errors and omissions that are never inconsequential, including a wrong dollar amount, use of the wrong form (i.e., one not acceptable to the IRS) or an improper method for delivery of the statement. In addition, any item in the recipient's address that is incorrect that could prevent or delay the recipient from being able to receive and use the information on the statement is not inconsequential. An example in the regulations indicates that the misspelling of "Boulevard" would be inconsequential, but that a transposition of numbers in an address would not be inconsequential. The instructions to Form 8971 and Schedule A have a similar definition of inconsequential errors and omissions, but go on to provide

[26] Prop. Reg. §1.6035-1(e)(1).

additional information in this regard. With respect to the Form 8971 and the Schedule(s) A provided to the IRS, an error or omission related to a TIN, a beneficiary's surname, or the value of an asset the beneficiary is receiving from an estate is never inconsequential. With respect to the Schedule A provided to a beneficiary, an error or omission related to a significant item in a beneficiary's address or the value of an asset the beneficiary is receiving from an estate is never inconsequential.

As a practical matter, the Form 8971 and Schedule(s) A should be treated with the same care given to Form 1099 and other similar informational returns. Most estate planning attorneys are not used to preparing these types of filings, so special attention will need to be given to each form to ensure that all of the information is properly reported to avoid harsh penalties, as discussed below. In addition, it would be wise for an executor to report any change in a supplemental filing other than the most minor typographical errors. Clearly an error in amount, a TIN, or a misspelled surname requires correction, as stated in the instructions. But, what if there is a misspelled first name, e.g., “Laura” or “Lori” or “Lara” instead of “Lora?” A cautious executor would file a supplemental Form 8971 and Schedule A for any change to a beneficiary's name or address.

3. Subsequent Transfer Rule. This rule, which is solely a creation under the proposed regulations, requires that a beneficiary report any later transfer of an asset received from an estate that was originally required to be reported on a Schedule A if the transfer is to a related transferee and that transferee determines its basis, in whole or in part, with reference to the transferor-beneficiary's basis. What transfers are included under this new rule and how are they reported?

a) *Short Answer*: Any beneficiary of an estate who receives assets that are reportable on Schedule A will need to report a subsequent transfer of any such asset if (i) the transferee is a related transferee and (ii) the transferee's basis is determined in whole or in part by reference to the initial beneficiary's basis. This report will be made on a Schedule A that is filed with the IRS and provided to the transferee within 30 days after the transfer. If the transfer occurs before the receipt of a Schedule A by the originally designated beneficiary, he or she must provide a Schedule A to the IRS, the transferee and the executor. This report will identify the asset but will not include a value (as presumably, none has yet to be given to the beneficiary) and is also due within 30 days after the transfer. The duty to file the Schedule A with the initial estate tax value to the subsequent transferee will then shift to the executor.

b) *Detailed Answer*: This rule attaches to nearly every asset received from an estate with a reporting requirement and appears to apply in perpetuity to the extent any portion of the asset is subsequently transferred to a related party. Let's parse out what assets and which recipients this rule affects.

There are three steps to determine if an asset is subject to this rule. First, the transferor of the property must determine if the asset should have been reported on a Schedule A, whether or not it was actually reported. If the answer to this question is yes, then the asset is potentially subject to this rule. Thus, assets that pass to a surviving spouse that are reported on a Schedule A, although not subject to the basis consistency rule under § 1014(f), may be subject to the Subsequent Transfer Rule. However, property that qualifies for an exception from reporting (e.g., tangible personal property excluded under proposed regulation § 1.6035-1(b)(1)(iii)) would not need to be reported under this rule, even if all of the other requirements of the rule are met.

Second, the transferor of the property must determine if the transferee is a related transferee. For these purposes, the proposed regulations define a related transferee as (i) any member of the transferor's family as determined under § 2704(c)(2), (ii) any controlled entity (any entity in which the transferor and his or her family as defined above have control, whether direct or indirect, as defined in § 2701(b)(2)(A) or (B), and (iii) any trust of which the transferor is treated as owner for income tax purposes (i.e., a grantor trust).[27] Section 2704(c)(2) defines family to include the transferor's spouse, any ancestor or lineal descendant of the transferor or the transferor's spouse, and any sibling or spouse of a sibling of the transferor. Section 2701(b)(2)(A) defines a controlled corporation as a corporation in which at least 50% (by vote or value) of the stock of the corporation is held by the transferor and his or her family. Section 2701(b)(2)(B) defines a controlled partnership as a partnership in which at least 50% of the capital or profits interests or any interest as a general partner in a limited partnership is held by the transferor and his or her family.

Third, the transferor of the property must conclude that the transferee will determine his or her basis, in whole or in part, by reference to the transferor's basis. This will occur in any transaction in which carryover basis applies, such as a gift to the transferee or a like-kind exchange. If the answer to all three of the above questions is "yes," then the asset will be subject to the Subsequent Transfer Rule.

If the Subsequent Transfer Rule applies, it will be important to determine who must give and who will receive the required subsequent report. If the asset has already been reported on a Schedule A by the executor of the estate, then the transferor-beneficiary will report the subsequent transfer on a Schedule A that is furnished to both the transferee and the IRS. This Schedule A will be completed in its entirety, including the value that was initially reported to the transferor-beneficiary (even though this may no longer be the basis in the hands of the transferor-beneficiary). If the transferor-beneficiary wants to supplement the statement with information regarding changes to the basis while held by him or her, the transferor-beneficiary may do so on the Schedule A. However, that information must be on a separate line or schedule so that the value reported on the initial Schedule A is identical to the value reported on the subsequently-filed Schedule A. Presumably this will allow the IRS to link the assets from the estate to each subsequent related-party owner of the asset. In the case of a transfer that occurs before the transferor-beneficiary of an estate receives the initial Schedule A, the transferor will also need to give a Schedule A to the executor of the estate. This additional requirement allows the executor to receive necessary information about the transferee, so that when the executor later prepares its required Schedule A, the executor will know who to give it to (i.e., the subsequent transferee rather than the initial transferor-beneficiary).

For example, suppose Beneficiary owns Blackacre as joint tenants with right of survivorship with Husband. At Husband's death, the interest in Blackacre vests in Beneficiary at date of death and is not subject to administration in Husband's estate. After Husband's death, Beneficiary makes improvements to Blackacre that increase her basis in the property. Shortly thereafter, Beneficiary makes a gift of Blackacre to Daughter. The estate tax return for Husband has not been filed, nor has the Form 8971 and Schedule(s) A. However, within 30 days after the gift, Beneficiary will be required to prepare a Schedule A to report the transfer of Blackacre to Daughter. This report will need to be given to Daughter, the IRS and the executor of Husband's estate. Because Beneficiary has not yet received a Schedule A, she does not need to include a value of Blackacre on the Schedule A that she prepares. However, she may separately report the value of the improvements to Blackacre, so that Daughter will have that information,

[27] Prop. Reg. § 1.6035-1(f).

which will be needed to determine her own basis in the property. When the executor later files Form 8971 and Schedule(s) A, the Schedule A that shows the value of Blackacre as reported on the estate tax return will be furnished to Daughter instead of to her mother, the Beneficiary. In addition, it appears that if Daughter 50 years later swaps her interest in Blackacre with her sister in exchange for her sister's interest in Whiteacre in a like-kind exchange, Daughter will need to furnish a Schedule A to her sister and to the IRS that provides the value of Blackacre as initially reported on Husband's estate tax return that was filed 50 years before.

c) <u>*Questions*</u>:

Does the IRS have the authority to impose this reporting requirement? This rule clearly demonstrates that the IRS is serious about keeping track of the basis, or at least the initially reported value, of inherited assets. The preamble to the proposed regulations indicates that § 6035(b) gives the IRS authority to establish this rule, as it is necessary to carry out § 6035. Many professionals have opined that this reading goes too far. Section 6035 specifically tasks the executor (or other person required to file an estate tax return pursuant to § 6018) with the responsibility of reporting initial basis. Grafting this requirement onto any type of subsequent transferee, whether related or not, appears to go beyond the authority given to Treasury and the IRS. As mentioned above, the basis consistency rules were contemplated to apply not only to transfers at death, but also to gifts during life. Congress specifically declined to apply the new rules that broadly when passing § 6035. Accordingly, it would seem that the IRS does not have the authority to extend the reach of § 6035 this far under current law. What should a beneficiary do if faced with a Subsequent Transfer reporting requirement? Without further guidance, it would appear prudent to advise any client faced with this issue to file a Schedule A with the IRS and furnish it to the transferee.

What should a beneficiary do if he or she does not receive a Schedule A from the executor but believes he or she should have? It is obvious that there are many uncertainties and questions surrounding the reporting requirements under § 6035. It is fairly likely that the reporting requirements will be interpreted differently among executors, beneficiaries and their advisors. What if the executor of an estate takes the position that she does not need to provide a Schedule A to a beneficiary who receives property from the estate because the property distributed was in satisfaction of a pecuniary bequest to the beneficiary and the estate recognized capital gain on the distribution? In this scenario, the executor interpreted the exception in proposed regulation § 1.6035-1(b)(1)(iv) to exclude this asset from the required reporting even though it was distributed to a beneficiary. However, what if the beneficiary who received the asset is more conservative, and interprets that regulation in way that she believes requires the asset to be reported to her on a Schedule A, so that when the beneficiary subsequently transfers the asset to her child, she believes that she is subject to the Subsequent Transfer Rule? The regulations would seem to require the beneficiary to furnish a Schedule A to the executor, the child and the IRS. What should the executor do with this information? What if there is no executor to give the Schedule A to because the administration of the estate is closed or the executor is deceased and no successor is appointed because there is no longer a need for administration of the estate? It is unclear how the IRS will respond in these situations. Hopefully there will be guidance forthcoming that will clarify enough of the uncertainties to eliminate these types of conundrums. In the meantime, the facts and circumstances of each case will likely steer executors and beneficiaries towards the result that makes the most sense. Clearly, the safest approach with respect to the IRS would be to always report.

How do the related party rules work in the context of trusts? Pulling in the related party definitions from §§ 2701 and 2704 were helpful to a certain degree, as most tax practitioners are familiar with the application of these definitions. However, these definitions do not take into account every possible scenario with respect to the Subsequent Transfer Rule. One big question is how these rules apply in the context of trusts. Grantor trusts with respect to the transferor are specifically included as a related party for purposes of this rule. However, it is unclear why this would be necessary with respect to a revocable trust that is treated as a grantor trust. For all tax purposes, the transferor-grantor of the trust will still be considered the owner of the trust. The need for subsequent reporting in this situation is mysterious. Possibly there will be clarification by the IRS that grantor trusts that are includable in the estate of the transferor-grantor will not be subject to this rule.

Application of the rule to individual trustees of a trust that is not a grantor trust is also unclear. For example, assume that Family Trust received assets from decedent's estate. Family Trust later distributes those assets in kind to a beneficiary of the trust. If Independent Bank is the trustee of Family Trust, there should be no subsequent reporting requirement, because beneficiary is not related to Independent Bank. However, what is the result if Mom is the trustee and Son is the beneficiary who receives the distribution? Is there a subsequent reporting requirement because Mom is related to Son? Or is there no requirement, because Mom, as trustee is making the distribution and a trustee in that capacity alone is not related to any other individual? It seems incongruous that the rules would be different based on the identity of the trustee. However, logic does not always apply when interpreting tax laws. Some thoughtful consideration will need to be given to this issue if it arises. There could be planning opportunities to avoid the issues altogether, depending on the flexibility given in the trust instrument relating to designation of successor trustees and delegation of powers among multiple trustees.

Alternatively, what if the trustee does not distribute the assets, but a beneficiary of the trust exercises a limited or special power of appointment over trust assets that results in a distribution of an asset to an individual who is related to the beneficiary? The transfer is directed by the related-party beneficiary, but implemented by the trustee of the trust. It is unclear if and how the Subsequent Transfer Rule would apply in this context. If reporting is required, should the trustee report the transfer or should the appointing beneficiary? It seems most logical that if reporting is required, that the trustee provide the Schedule A to the recipient. Although there is no certainty that any reporting is required, it does appear that there would be no complaints by the IRS for over reporting.

How will a beneficiary know about the Subsequent Transfer Rule? Executors are clearly on notice of these new reporting rules and advisors are geared up to provide advice on how to comply with their obligations. However, once they provide the required Schedule A to a beneficiary, they owe no further duties to advise beneficiaries on their potential subsequent reporting requirements. What about the beneficiaries who receive assets from an estate? How will they know that they may be subject to the Subsequent Transfer Rule? It's not unusual for individuals to make gifts of property without telling an advisor (really!). If a beneficiary of an estate receives a Schedule A, there is nothing on that schedule to indicate any subsequent reporting requirement. Although § 1014 is referenced at the bottom of the schedule, § 6035 is not. Even for a curious beneficiary who looks up the instruction for Schedule A, there is no information to be found with respect to the Subsequent Transfer Rule. As advisors, this will be one more question to ask of our clients: Did you inherit any property that was reported (or required to be reported) on an estate tax return after July 31, 2015? Hopefully these concerns will be addressed by the IRS when they revise the forms and clarify the scope of the Subsequent Transfer Rule. Until then, it might be a best practice to be extra nosey by asking your clients to let you know if they inherit property and decide to transfer or otherwise dispose of that property in any way.

C. WHEN? Not only is it important to know when the executor is required to file the initial Form 8971 and Schedule(s) A with the IRS and furnish an initial Schedule A to each beneficiary who is required to receive one, but it is also important to know the deadlines for a Supplemental Reporting and a transfer that falls under the Subsequent Transfer Rule. Each of these three time frames are addressed separately below. Finally, we'll review when penalties may apply for failing to timely file a complete and accurate Form 8971 or failing to timely furnish a Schedule A, including the ultimate penalty, the "Zero Basis Rule" of proposed regulation § 1.1014-10(c)(3).

1. Initial Form 8971 and Schedule(s) A. What is the general rule for reporting under § 6035?

a) *Short Answer*: The initial Form 8971 and Schedule(s) A are due on the date that is the earlier of (i) 30 days after the due date (with extensions) of the estate tax return, or (ii) 30 days after the return is actually filed.[28] However, due to the extension granted by the IRS, the due date for Form 8971 and Schedule(s) A for estate tax returns filed after July 31, 2015 and before June 1, 2016, was June 30, 2016.[29]

b) *Detailed Answer*: The Act provides that § 6035 applies to property with respect to which an estate tax return is actually filed after July 31, 2015. This means that the rules will also apply to returns that were due prior to July 31, 2015, but were filed after that date, no matter what the reason.[30] However, the regulations provide for a transition rule that makes the Form 8971 and Schedule(s) A deadline 30 days after the date an estate tax return is actually filed if the returns should have been filed on or before July 31, 2015 but it is not filed until after that date.[31] This extension of time is also set forth in the instructions to Form 8971, although the instructions are imprecisely worded and appear to give the extension of time for any late-filed return. Based on some taxpayer's prior experiences relating to reliance on IRS guidance, it would be wise for executors not to count on the broadly-worded instructions when advising about filing deadlines.[32] A literal reading of the proposed regulatory provision seems to indicate that if you are late in filing an estate tax return that had a filing deadline of July 31, 2015, the first day of the 30-day timeframe for the filing of Form 8971 and Schedule(s) A will not start to run until you actually file the return. However, if you have an estate tax return with deadline that is one day later, August 1, 2015, that Form 8971 and Schedule(s) A will be due on June 30, 2016 and penalties will begin to accrue if they are not filed by that date. It may be that any other rule would have been considered a retroactive application of the law, which resulted in this interesting transitional rule. In any case, it will normally be prudent to advise an executor who is delinquent in filing a required return to file both the tax return and the Form 8971 and Schedule(s) A as soon as possible to avoid potential penalties.

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[28] § 6035(a)(3)(A).
[29] Notice 2016-27 (see discussion above).
[30] Prop. Reg. § 1.6035-1(d)(1).
[31] Prop. Reg. § 1.6035-1(d)(2).
[32] *See* Bobrow v. Commissioner, TC Memo 2014-21 (Jan. 28, 2014) (taxpayer who relied on guidance in an IRS publication and proposed regulations relating to IRA rollovers found liable for penalties for exceeding allowable rollovers in one year).

2. Supplemental Reporting. If a supplemental report is required to be filed, when is it due?

a) *Short Answer*: A supplemental report is generally due 30 days after the date on which the reason for the supplemental return is identified. However, if a supplemental report is required with respect to an asset that has not yet been distributed to a beneficiary from the probate estate or a revocable trust, that supplemental Form 8971 and Schedule A will not be due until 30 days after the asset is distributed to the beneficiary.[33]

b) *Detailed Answer*: The date on which the 30-day deadline begins to tick will depend on what triggers the supplemental filing. If the reason for the supplemental report is a redetermination of the value of an asset on the return, the clock will start ticking on the date the final value of the asset is determined. The proposed regulations provide that the final value is (i) the value on the return as reported if it is not timely adjusted or contested by the IRS prior to the expiration of the statute of limitations, (ii) the value determined by the IRS if the taxpayer does not timely claim a refund or credit prior to the expiration of the statute of limitations, (iii) the value determined by a final and binding agreement, or (iv) the value determined by a court once that determination is final.[34]

If the reason for the supplemental report is to report an error or omission that requires a supplemental report, the clock will start ticking on the date the error or omission is discovered.[35] If the reason for the supplemental report is because the executor is filing a supplemental estate tax return to report property omitted from the prior return(s), the clock will start ticking on the date the supplemental return is filed.[36] Interestingly, the IRS has provided an overall exception for assets that have not been distributed to a beneficiary from the probate estate or a revocable trust at the time the supplemental reporting requirement arises. That exception provides that the supplemental Form 8971 and Schedule A is not due until 30 days after the asset is in fact distributed to the beneficiary. This exception to the general rule is very practical. Hopefully the IRS will be willing to carry over this position in other situations where the information will not be needed by a beneficiary before he or she actually receives the asset.

c) *Questions*:

How do you know when the final value is actually final? Particularly with respect to valuations that are the subject of judicial determination, it is unclear when a court's determination is final. Once a court has ruled, that court's ruling is generally final. However, either of the parties typically is able to appeal the ruling to a higher court. Presumably the reference in proposed regulation § 1.1014(c)(1)(iv) to a "final" ruling means either when the time to appeal has expired with no such appeal filed or when an appeal to the U.S. Supreme Court has not been selected to be heard by the Court.

Is there a requirement to file a Form 8971 and Schedule(s) A in connection with a supplemental return filed after July 31, 2015 for a return with an initial due date on or before that date? At first blush, the proposed regulations appear to broadly apply to any supplemental return filed after July 31, 2015. However, on closer inspection, it

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[33] Prop. Reg. § 1.6035-1(e)(4)(ii).
[34] Prop. Reg. § 1.1014-10(c)(1).
[35] Prop. Reg. § 1.6035-1(e)(4)(i)(B).
[36] Prop. Reg. § 1.6035-1(e)(4)(i)(C).

seems that the rules may not apply to a supplemental return filed in connection with an estate tax return initially filed on or before July 31, 2015. Under proposed regulation § 1.6035-1(i), the reporting rules will apply to a "return required by § 6018" that is filed after July 31, 2015. The only return required under § 6018 is the timely-filed estate tax return, which may later be supplemented but which cannot be amended.[37] Because any supplemental return that is filed does not actually amend the return, the supplemental return is not a return required by § 6018. Thus, it does not appear that a supplemental return filed in connection with an estate tax return that was originally filed on or before July 31, 2015 is a return that is subject to § 6035 and no Form 8971 or Schedule(s) A should be required to be filed. As discussed above, the analysis on how to best comply under these circumstances will involve weighing the risks and rewards of the two options (to report or not to report).

If a decision is made to report the supplemental information on a Schedule A, then the executor will need to decide exactly what needs to be reported and to whom. It seems logical that a supplemental filing of this type will only require the executor to report the assets included on the supplemental return and not assets that were previously reported on the originally filed return that remain unaffected by the supplemental filing. Consistent with this approach, only the beneficiaries of the estate whose interests are affected by the supplemental return should receive a Schedule A. Under the currently drafted rules, these would appear to be safe assumptions to make. However, clarification by the IRS will be much appreciated.

3. Subsequent Transfer Rule. If the Subsequent Transfer Rule applies, when must the Schedule A reporting the transfer be filed with the IRS, furnished to the transferee, and, if required, provided to the executor?

a) *Short Answer*: The new Schedule A is generally due 30 days after the date on which the gift, sale or transfer occurs.

b) *Detailed Answer*: Under the Subsequent Transfer Rule, a beneficiary who transfers an asset subject to the rule is required to report that transfer on a Schedule A that is filed with the IRS and furnished to the transferee no later than 30 days after the transfer. If the transfer occurs prior to the receipt of the initial Schedule A from the executor of the estate, then the transferor-beneficiary must also provide a copy of the Schedule A to the executor of the estate within that same 30-day period. In that case, the executor will then be required to furnish the Schedule A from the estate to the subsequent transferee instead of to the initially intended beneficiary no later than 30 days after the original due date of the Form 8971 and Schedule(s) A, or any supplemental return, as discussed above.[38]

4. Penalties. For penalty purposes, the Form 8971 is considered an information return and the Schedule A is considered a payee statement. The IRS has simply slotted these new returns into longstanding statutory provisions. This means that the rules and procedures that apply are well-established and will be fairly simple for the IRS to implement even with this confusing new law. What penalties will apply for late filing, failure to file, or other mistakes made while we (including the IRS) are all trying to work through the uncertainties of the new rules? In addition, what penalties apply when a beneficiary who is subject to the consistent basis reporting requirement under § 1014(f) reports an inconsistent basis?

a) *Short Answer*: Any failure to timely file or to file a correct and complete Form 8971 and Schedule(s) A with the IRS will be subject to penalties under § 6721.

[37] Prop. Reg. § 20.6081-1(d).
[38] Prop. Reg. § 1.6035-1(f).

Penalties for those same failures with respect to the Schedule A provided to a beneficiary will be imposed under § 6722. Waiver of any penalties for reasonable cause are provided under § 6724. The penalties for reporting a basis that exceeds the amount reported on Schedule A are determined under § 6662, which provides for penalties imposed on underpayments.

b) *(Somewhat) Detailed Answer*: Penalties for failure to file on time or failure to file a complete and correct information return with the IRS such as the Form 8971 and Schedule(s) A can draw a steep penalty. That penalty is $260 for each return to which a failure occurs, not to exceed a total penalty of $3,193,000. If a failure is corrected within 30 days after the required filing date, the $260 penalty is reduced to $50 and the total maximum for corrected returns is reduced to $532,000 (with all of the above penalty limits adjusted for inflation). The penalties can be much higher in cases of intentional disregard and lower if receipts are less than $5,000,000. It is not clear if the receipts of the estate or those of the decedent prior to death will be used for this calculation. Presumably the receipts of the estate will be the relevant number. There are also certain exceptions for de minimis errors and certain errors corrected by August 1 of a calendar year under §§ 6721 and 6722. It is unclear how these will apply to estates, which do not have a filing deadline that is tied to the calendar year in any way. The instructions to Form 8971 make it clear that for purposes of applying the penalties, each Form 8971 and all of the Schedule(s) A filed with a Form 8971 count as only one return and will be subject to one penalty. However, the penalties for failing to provide Schedule A to a beneficiary will apply to each Schedule A that is not so provided. In addition, as the instructions further warn, using the terms "none," "unknown," or similar language when reporting a beneficiary's TIN on Form 8971 will cause the form to be considered incomplete and may cause the estate to incur penalties.

The penalty for reporting a basis that exceeds what is reported on Schedule A is 20% of the underpayment of tax that is due to the understatement of income. In general, the penalties increase if there is a substantial understatement.

A more detailed discussion of the imposition of penalties under these sections of the Code is beyond the scope of this article due to the variety of taxpayers, dollar amounts and circumstances that can affect the amount of the penalty in a particular situation. Suffice it to say that mistakes will inevitably occur. Identifying them early and filing a supplemental report as quickly as possible will go a long way towards showing the IRS that the executor tried in good faith to comply. If the executor can demonstrate that the failure to file a correct Form 8971 and Schedule(s) A with the IRS or to furnish a correct Schedule A to a beneficiary was due to an event beyond the executor's control or due to significant mitigating factors, the penalties may not be imposed.[39]

5. Zero Basis Rule. Last but not least, what appears to be the ultimate penalty is the provision in § 1.1014-10(c)(3) that provides for a "zero" basis in any assets that are not reported on a return prior to the termination of the statute of limitations. How can this be?

a) *Short Answer*: The IRS has taken a hard stance in situations where after-discovered or overlooked assets are omitted from the estate tax return, and likewise omitted from the Schedule A reporting system. If no supplemental return is filed to report an asset (whether because the statute of limitations has expired or otherwise), the basis in the unreported asset will be zero in the hands of the recipient-beneficiary. However, as long as the asset is reported to the IRS and to the beneficiary-recipient

[39] Reg. § 301.6724-1.

before the period of limitations expires with respect to the estate tax return this draconian rule will not apply.

b) *Detailed Answer*: Proposed regulation § 1.1014-10(c)(3) provides the rules for after-discovered or omitted property. The rule fairly directly states that if this type of property is reported on an estate tax return before the expiration of the period of limitation on assessment of estate tax, then the final value of the property for estate tax and basis purposes will be the value as finally determined under the usual rules. However, if such the after-discovered or omitted property is not reported on an estate tax return filed before the period of limitation on assessment expires, the final value of that property in the hands of the recipient-beneficiary is zero, zilch, nada. In addition, if no return has been filed for an estate, and if inclusion of the after-discovered or omitted property would generate or increase the estate's tax liability, the final value (and the associated basis in the hands of the recipient-beneficiary) of all property includible in the gross estate that is subject to the consistent basis requirement is zero, until a return is filed and the final value is determined under the usual rules.[40] Although there is uncertainty about the IRS's authority to implement this rule and its application to certain types of assets, as discussed below, the rule itself is fairly clear. It will be important to advise executors that, unless the rules are changed, they need to promptly report any assets that may be later discovered on a supplemental estate tax return after the initial return has been filed.

c) *Questions*:

Can the IRS and Treasury do that? It is unclear how the IRS and Treasury are able to implement this rule in the regulations when there is no parallel or delegating language to do so in the statute. While § 1014(f)(4) states that "[t]he Secretary may by regulations provide exceptions to the application of this subsection," creating a whole new rule that completely eliminates basis in assets does not constitute an "exception" to the application of § 1014(f), but rather a significant expansion of existing law. Indeed, it is generally acknowledged that there has not been a requirement to supplement an estate tax return for after-discovered or unintentionally omitted property from an estate tax return. Imposing a penalty on a beneficiary for an executor's failure to file a return he or she has no legal obligation to file is inappropriate and overreaching.

In addition, it is not clear if § 1014 will apply to these types of assets in any event. Section 1014(f)(3) requires that the value of property is determined for purposes of the application of § 1014 if the value is shown on a return and not contested, specified by the Secretary, or determined by a court or by a settlement agreement with the Secretary. If property is not reported on an estate tax return, none of those conditions are met. Thus, it would appear that the basis consistency rule of § 1014(f)(1)(A) does not apply. Additionally, § 1014(f)(1)(B) will not apply, because an unreported asset will not be reported on a Schedule A. If § 1014(f)(1) does not apply at all, then there can be no limitation on the basis of an asset that a beneficiary receives from a decedent.

While it is reasonable for the IRS and Treasury to want to take the position that there would be no basis in property that is not included on an estate tax return, there does not appear to be any basis in the law to do so. However, unless the executor you are advising wants to be the test case for this controversy, it makes sense to advise executors of this risk at the outset so that they can consider the consequences when determining how diligent they may want to be in searching for assets of the estate.

[40] Prop. Reg. § 1.1014-10(c)(3)(ii).

Can cash have a zero basis? If the zero basis rule does apply, how will that affect the later discovery of cash? Presumably gain will need to be recognized at some point if the initial basis is zero. Will the recognition date be the date of discovery, or the date on which the limitation period expires to report the asset on an estate tax return if after the discovery?

D. WHERE? All Forms 8971 and Schedules A must be filed with the Cincinnati service center:

Department of the Treasury

Internal Revenue Service Center

Mail Stop #824G

Cincinnati, OH 45999

It is important to note that although a Form 8971 and the Schedule(s) A must be filed together, they must not be attached to or filed with the estate tax return. Estate tax returns are filed at the general address, while these special reporting forms have their very own mail stop. VIP treatment for the new stars on the tax compliance team – they get their very own locker room! Lore from the ACTEC practice list serve indicates that if an estate tax return is selected for audit, then the From 8971 and Schedule(s) A will be sent to the auditor in connection with the audit.

1. Completing the Forms. Now that you have all of the answers as to who, when, what and where, completing the forms will be a snap! It is my understanding that some of the 706 software has been retooled to complete Form 8971 for you based on your initial input (e.g., GEMS software), while other programs maintain fillable forms that do not automatically populate (e.g., UltraTax).

a) Completing Form 8971. The important thing to note about this form is that no values are reported on this return. The Form 8971 is basically a transmittal cover sheet for the Schedule(s) A that are included in the filing with the IRS. Accordingly, aside from circumstances that may prevent the executor from getting the information needed to complete this form, it is fairly easy to complete.

The top of the form provides a check box to indicate if this is a supplemental filing required under the Supplemental Reporting rules. Part I of Form 8971 contains information that can be pulled directly from part 1 of the 706, with the alternate valuation election coming from Part 3. Any beneficiary who will receive a Schedule A (as discussed above) must be listed on Form 8971, along with his, her or its SSN, ITIN or TIN, and full address. The executor will also need to include the date on which the Schedule A was provided to each beneficiary listed on the form. It is not entirely clear, but a reasonable interpretation would be that this should be the date the notice was mailed (by email, U.S. mail or private mail service) or personally delivered to the beneficiary and not the date it was actually received by the beneficiary. Part II of the form also requires the executor to list how many beneficiaries have received or are expected to receive property from the estate. It is not entirely clear if the IRS wants to know all beneficiaries who will receive property from the estate or if they want to know the number of beneficiaries who will be receiving a Schedule A from the executor. It seems likely that the latter is the information that the IRS needs. Similarly, it is unclear what this number should be if a supplemental filing is being submitted. Should this number only reflect the Schedule(s) A that will be provided in connection with the supplemental return or all? To be on the safe side, you may want to choose one method or the other, and notate in an attachment how you arrived at the number included on the return.

In addition, because of the exceptions to reporting under proposed regulation § 1.6035-1(b), there could be situations in which no Schedule A must be provided. Although it seems unnecessary to file a Form 8971 in these circumstances, there does not appear to be an exception to the general rule for this. Thus, it would be prudent to file the Form 8971 without any accompanying Schedule A. Because all of this reporting is so new to both advisors and the IRS, it may be advisable to note the reason no Schedule A was attached to forestall unnecessary communications from the IRS.

b) Completing Schedule A. The top of this form also provides a check box to indicate if this is a supplemental filing required under the Supplemental Reporting rules. The general information requested in Part 1 includes the names and SSN/TIN of the decedent and the beneficiary, along with the executor's name, address and phone number. Part 2 of the form requests very detailed information about the property passing to a beneficiary. Column B requires a description of the property and the Schedule and Item number from the decedent's estate tax return. The instructions provide that the description included here must be the same that is used on the estate tax return. If the beneficiary will acquire a partial interest in an asset that information also needs to be noted in this column. Column C requires a Y (yes) or N (no) answer to whether the assets increased the estate tax liability. If any estate tax is due, then the answer to this will always be Y, except in the case of assets passing to or for the benefit of a spouse that qualifies for the marital deduction or assets passing to charity that qualify for the charitable deduction. If no estate tax is due, then the answer to this will always be N. Column D requests the valuation date, which will be either the date of death or the alternate valuation date. Column E requires the estate tax value to be reported, which may change on a supplemental filing.

c) Transmitting the Forms. A paper copy of Form 8971 and the related Schedule(s) A must be mailed to the IRS by the same methods that an estate tax return can be mailed. There are a few more options for delivery of a Schedule A to a beneficiary. In addition to U.S. Mail and private mail services, the Schedule A can also be emailed or delivered in person to the beneficiary. The instructions require the executor to retain proof of mailing, proof of delivery, an acknowledgement of receipt or other evidence of delivery. This type of evidence is fairly easy to obtain with mail, and a signed receipt for personal delivery will be an effective way to acknowledge receipt. However, the use of email to furnish the Schedule A to a beneficiary would only seem appropriate in circumstances in which you are certain the beneficiary will acknowledge receipt by return email or otherwise acknowledge receipt in a sufficient fashion to protect the executor. The instructions also note that in the case of an estate or trust beneficiary with multiple fiduciaries, delivery of the Schedule A to one trustee or executor is sufficient to meet the delivery requirement to that beneficiary.

2. Advising the Beneficiaries. Although it might be tempting for the attorney who is assisting the executor to provide advice and information to the beneficiaries of the estate with respect to the information provided to each of them on Schedule A, this should be done with great caution. The executor and the beneficiaries of an estate often have potentially conflicting interests. Indeed, most of us have engagement letters that explicitly state that we are only representing the executor of the estate and do not represent the beneficiaries. It will make sense to ensure that any additional information provided to the beneficiaries of an estate is carefully worded so that there can be no implication that you are advising them as their counsel. Undoubtedly there will be confusion created with this reporting, as the value that is reported on the estate tax return and the Schedule A that is the "initial basis" of a beneficiary of the estate (and his or her subsequent transferees) will often not be the actual basis in the

hands of that person. A sample letter that you may want to consider using when transmitting Schedule A to a beneficiary is attached as Exhibit 1.

IV. Additional Forms. Keep in mind that the Form 8971 is a separate return from the Form 706, so as a preparer you may want to have the ability to discuss the return with the IRS or at least receive notice regarding any questions that arise with respect to the form.

A. Form 2848 – Power of Attorney and Declaration of Representative. This power of attorney will allow you to speak with the IRS regarding any matters authorized in the form. The form allows you to designate no more than two representatives to receive notices and communications. This limitation will apply not only to attorneys-in-fact listed on this form, but also to any appointees indicated on Form 8821, discussed below. It will be important to coordinate the filing of these forms with the CPA for the estate to ensure that the notices are going to the right advisors.

The form allows the taxpayer to authorize additional acts, such as giving authority to disclose information to third parties or to sign a return. It also allows the taxpayer to specifically limit that acts that can be performed. The execution of a subsequent power of attorney will revoke all previously filed powers of attorney on the same matters and tax years unless the old power of attorney is attached to the new form and the election to keep the old power of attorney in place is affirmatively made on the form (line 6). The taxpayer must sign and date the return. The designated attorney(s)-in-fact must also sign and date the return, providing their professional credentials and licensing jurisdiction in Part II of the form.

It is important to note that the instructions to Form 8971 have specific directions on how to complete Form 2848 for the Form 8971. For this return, the new instructions state that the executor should be listed as the taxpayer as opposed to the estate itself. Correspondingly, the executor's social security number will be used. This is a curious instruction, as the instructions to Form 2848 state that the decedent's name (along with the executor's name) and the decedent's social security number should be used for Form 706. The role of the executor is the same in both instances, making the reason for the disparate treatment is unclear. In the section for acts authorized (line 3), the new instructions say that the description should be "Civil Penalties." This is an interesting instruction as well, as the Form 2848 instructions state that a representative is authorized to represent a taxpayer with respect to penalties in connection with the specific tax return listed without adding this in and that you would only include this if the penalty was not related to the specified return. Clearly these two sets of instructions are at odds with each other. Because of the constant flux in the Form 8971 instructions, it might be appropriate to follow the instructions for Form 2848 where they conflict. Worst case scenario is that you will need to obtain an additional Form 2848 if the originally prepared form is not accepted. There are some additional instructions that do not conflict with the existing Form 2848 instructions. One is that the tax form number provided in the section for acts authorized (line 3) should be Form 8971/Schedule A. Another is that the decedent's date of death should be listed as the year or period applicable in that section. The format for this includes the year and month, so that if the decedent died on 1/1/2019, the date would be shown as "201901" (with no dash or slash, per the instructions).

The instructions indicate that the taxpayer is not required to use this exact form and that a substitute form that meets the requirements of a power of attorney can be used instead. This power can be attached to a Form 2848 that is signed by the designated attorney(s)-in-fact. The taxpayer can revoke a power of attorney by either (i) preparing a new power for the same returns and years or (ii) writing "REVOKE" at the top of the first page of the form, with a signature and date below this annotation, and filing it with the IRS. A representative can withdraw from representation by writing "WITHDRAW' at the top of the first page of the form, with a signature and date below this annotation, and filing it with the IRS. If either the taxpayer or representative want to revoke or withdraw but he or she does not have the form, a letter can be prepared to send to the IRS with the relevant information to do so. Generally, this includes the relevant names, addresses, tax periods and forms.

Although the IRS will more readily rely on copies of forms, a best practice will be to get at least 2 original Form 2848s signed by the executor. One will need to be filed with the Form 8971. Having a spare original in your files could come in handy.

B. Form 8821 – Tax Information Authorization. This form is similar to the Form 2848 power of attorney, but different. This form merely allows the designated appointee to receive information with respect to specified tax matters. As with the power of attorney, the execution of a subsequent Form 8821 will revoke all previously filed tax information authorization forms on the same matters and tax years unless the old form is attached to the new form and the election to keep the form in place is affirmatively made on the new form (line 6). The taxpayer must sign and date the return. This form may be useful for professionals who need to be advised regarding the status of various tax matters, but who do not want the responsibility for discussing matters with the IRS. For example, if the attorney is preparing the Form 8971 and Schedule(s) A, he or she will want to have a Form 2848 in place. However, the decedent’s CPA may also want to be apprised of the status of these filings. A nice feature of Form 8821 is that you can designate not only an individual, but a corporation, firm or any other organization as your appointee. This means that the decedent’s CPA firm can be designated on this form rather than just one individual. If this is not a form you are currently using, you may want to consider it as a good way to keep other client team members informed. However, keep in mind that the IRS will only send notices to two designees, so you will want to save one of those slots for the designated attorney-in-fact under the power of attorney.

V. Estate Administration Protocols. There are steps that can be taken during the administration of an estate that could go a long way toward making compliance with the value reporting rules a little less burdensome and the associated risks to the executor a bit lower.

A. Obtain Beneficiary Information Early. Previously, executors were not too concerned about getting addresses and TINs from beneficiaries, as they could withhold the distribution until that information was received. With a fixed deadline of 30 days following the estate tax return due date, there is no leverage that can be easily used against wayward beneficiaries. It will be important for executors to make efforts early to identify beneficiaries and obtain the necessary information or have sufficient documentation of those attempts prior to filing the estate tax return.

B. Change the Nature of Estate Assets before Filing the Form 8971. Keep in mind that the reporting rules only apply to assets that were included on the estate tax return and distributed to beneficiaries (along with property that has a basis determined in whole or in part by such property). When appropriate, the executor should consider disposing of estate assets during the estate administration period. For example, if a decedent holds only marketable securities and assets exempted from reporting (e.g., cash, certain personal property and IRD), the executor could liquidate the securities before filing the estate tax return. By doing so, the reporting requirement would be limited to a Form 8971 to report that there were no assets to be reported on a Schedule A.

C. Make Distributions before Filing the Form 8971. Executors tend to hang on to everything in an estate until the final closing letter is received out of an abundance of caution. This is certainly appropriate in some cases, but not all. In order to reduce some of the compliance headaches, it may make more sense now to make distributions before the Form 8971 is due (with refunding agreements, as appropriate). While this step will not eliminate the reporting requirement entirely, it will make it much easier based on the simple fact that the executor knows what each beneficiary actually received and can fill out the Schedules A accordingly. Of course, the pros and cons should be weighed carefully before taking this approach.

D. Obtain Release from Beneficiaries. For beneficiaries who will be subject to the basis consistency rules, the value reported on the estate tax return in connection with any asset they receive from the estate has just become very important. Prior to these rules, beneficiaries were generally not bound to the value set by an executor. Now, however, those beneficiaries will be bound to the reported values unless they are able to successfully challenge them in court. In cases in which a beneficiary has no input on the valuation used, this can result in an unfair, or a perceived unfair result. In estates in which concerns may arise in this regard, the executor may want to consider if it would be appropriate to communicate with the beneficiaries regarding the values to be used for tax reporting. This could arise in connection with both the initial 706 filing and any negotiated adjustments on audit. Any agreement with the beneficiary along these lines could be incorporated into a receipt, release and agreement to refund entered into with the beneficiary. The executor will explicitly want to include provisions that release the executor from the valuations used to protect the executor from beneficiaries that may later come back complaining about basis that is too low.

VI. Conclusion. Preparing estate tax returns, and the related forms, has never been easy. With the addition of the new basis consistency rules, we have been challenged to learn how to apply this new law and to adjust our practice and procedures in a way that will allow us to be the most responsive to our clients.

Exhibit 1

Sample Cover Letter to Accompany Schedule A to Form 8971 Sent to Beneficiary by Executor

Dear [Beneficiary]:

As you know, I am serving as Independent Executor of the Estate of [Decedent]. Pursuant to federal law, I am required to provide certain information to you as a beneficiary of the Estate. Please find [enclosed/attached] a completed Schedule A to Form 8971 that contains this required information, a copy of which is also being provided to the Internal Revenue Service as required by law.

The Schedule A provides you with information about the value of property as reported on the estate tax return of the Estate that you have already received or may receive from the Estate. This information may be important to you if you later sell, give, or otherwise transfer all or any portion of the ownership of the property that you receive from the Estate. Please consult your own tax advisor regarding your federal income tax obligations with respect to this information and possible tax penalties for failure to comply with federal law in connection with this information.

Sincerely yours,

[Executor],
Independent Executor,
Estate of [Decedent], Deceased