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## Estate Taxes

The Surface Transportation Act enacted in July includes a number of tax compliance measures—including some paving the way for the IRS to close gaps in inconsistent estate basis reporting and imposing additional filing requirements on estates. This article by Stefanie J. Lipson of Greenberg Glusker takes a look at the estate basis filing and reporting provisions, particularly the “separate statement” provision that directs practitioners and tax preparers to submit a “statement” to the IRS and any beneficiary who receives property showing the same information as that found on the estate tax return.

### Surface Transportation Act Paves New Road to Estate Tax Reporting Compliance

By STEFANIE J. LIPSON

**T**he Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 (Pub. L. No. 114-41), signed into law by President Barack Obama on July 31, provides temporary funding for highway and transportation projects by introducing new tax compliance measures. In addition to modifying tax return filing deadlines for partnerships and increasing the information reported in a mortgage interest statement, the tax compliance measures in the Surface Transportation Act target a perceived abuse of inconsistent basis reporting of property inherited with a stepped-up basis when a sale of the property is later reported by the beneficiary.

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In general, Internal Revenue Code Section 1014 provides that the basis of property received from a decedent has a basis equal to its fair market value on the date of the decedent's death. The result is that the beneficiary takes the property with a new basis, eliminating the possibility of income tax on the property's appreciation that took place during the decedent's lifetime, or in the case of property for which the decedent received the benefit of depreciation, resetting the basis to fair market value without an income tax recapture.

Obama has referred to this stepped-up basis as “perhaps the largest single loophole in the entire individual income tax code,” and various proposals, including the president's most recent budget proposal, would seek to modify or eliminate the stepped-up basis rule.

#### New Statement Requirement

The Surface Transportation Act doesn't eliminate or attack stepped-up basis. Rather, in what appears to be an effort to better facilitate consistent reporting and information flow between the income tax and estate and gift tax divisions of the Internal Revenue Service, newly enacted tax code Section 6035 directs the executor of any estate required to file an estate tax return—or the beneficiary, if the beneficiary is filing the return in some circumstances—to provide a “statement” to the IRS and to each person receiving property that was included in the decedent's estate. The statement must

identify the value of each interest in the property as reported on the return.

Note that for an estate electing portability of a deceased spouse's unused credit amount under Section 2010(c)(5), the return is considered required under Section 6018(a), even where a return wouldn't otherwise have been required but for the desire to elect portability.<sup>1</sup>

The separate statement is required to be furnished no later than 30 days following the due date (including extensions) of the return, or the actual filing of the return, whichever is earlier.

Section 6035 instructs the treasury secretary to provide regulations that address both (1) application of the section in circumstances where an estate tax return is not required, and (2) circumstances where a surviving joint tenant or beneficiary of the property may have more accurate basis information than the executor. Section 6035 doesn't address any statement requirement where property has been acquired by gift, wherein the basis is determined under Section 1015, or transferred during the decedent's lifetime in a manner that results in no inclusion in the decedent's estate.<sup>2</sup>

Basis consistency reporting proposals for property with a carryover basis received by gift or received at a decedent's death in 2010 under the Section 1022 modified carryover basis rules were included in the administration's budget proposal explanations, but aren't included in the Surface Transportation Act.

The requirement to furnish the statement to the IRS and to the beneficiary is effective for all returns filed after July 31, 2015. However, pursuant to Notice 2015-57, effective Aug. 21, 2015, the due date for all Section 6035 statements that would be due prior to Feb. 29, 2016, is delayed until Feb. 29, 2016. The notice instructs that such statements shall not be furnished until a form is issued for such purpose or until further guidance is provided.

Additional provisions of the Surface Transportation Act make failure to provide these statements subject to penalties under Sections 6721 and 6722.

## Consistent Reporting, Penalties and Extended Statute of Limitations

New Section 1014(f)(1) provides that the acquirer's basis in property, which is adjusted under Section 1014(a) to "fair market value," can't exceed the final value determined for estate tax purposes (if it has been so determined) or, for other property where a statement

has been made under Section 6035, the value on such a statement.

Section 1014(f)(1) appears to apply only to estates for which a return was required, targeting larger estates with a value in excess of the credit amounts and seeking to prevent the acquiring beneficiary from later claiming, for basis purposes, the estate tax value didn't reflect fair market value.

The final value determined for estate tax purposes is (1) the value stated on the return, if not challenged prior to the expiration of the statute of limitations, (2) the value as set by the IRS, if not timely challenged by the executor, or (3) the value determined by a court or pursuant to settlement agreement with the IRS.

The provisions of Section 1014(f)(1) only apply to property which, by its inclusion in the decedent's estate, increased the decedent's estate tax liability, as reduced by credits allowable. This language would seem to exempt property included in the gross estate and qualifying for the federal estate tax marital deduction, because inclusion of such property didn't increase the estate tax liability, and the potential tax liability was reduced by a deduction against the estate, not a credit.

This basis consistency requirement could lead to beneficiaries seeking to be more actively involved in the valuation and estate tax reporting process, and possibly more disputes between a beneficiary receiving property and the executor or trustee reporting its value, where the beneficiary will be later bound by the estate value determination for basis purposes.

For example, a beneficiary who receives a specific bequest of property that doesn't bear its proportionate share of estate tax is now further incentivized to advocate for a higher reported value of the property on the return. Certainly, where the beneficiary bears estate tax on his or her bequest, this incentive to report a higher value is mitigated by the increased estate tax liability attributed to the beneficiary's share.

Additions to Section 6662 impose a 20 percent accuracy penalty for reporting inconsistent estate basis, defined as when "the basis of property claimed on a return exceeds the basis as determined under Section 1014(f)." Additions to Section 6501 also bring "an overstatement of unrecovered cost or other basis" within the reach of the extended six-year statute of limitations for a "substantial omission" on the return (generally, the omitted amount is in excess of 25 percent of the gross income stated in the return). Note that the substantial omission for an overstatement of basis isn't limited to estate basis issues.

## Conclusion

The expected revenue from these estate tax/income tax basis consistency provisions and the overstatement of basis provisions is a combined \$2.7 billion over a 10-year period.

It is doubtful that practitioners and tax preparers will be taken aback by a requirement to report basis consistently. Rather, the real impact of these new provisions is the additional requirement to file a separate statement after the estate tax return and provide the same information to the beneficiary receiving the property, binding the beneficiary to accept the estate tax value as the adjusted basis and ensuring clear authority to impose failure-to-file penalties and accuracy-related penalties.

<sup>1</sup> Treasury Regulations Section 20.2010-2(a)(1).

<sup>2</sup> There are practitioners who take the position that certain property held in an irrevocable grantor trust (a trust treated as the same income taxpayer as the grantor under Section 671 et. seq.) should receive a basis adjustment under Section 1014 at the decedent's death, notwithstanding the property of the trust isn't included in the decedent's gross estate. This subject is beyond the scope of this article. Earlier this summer, though, in Revenue Procedure 2015-37, the IRS said it will no longer provide letter rulings or determinations on whether assets in a grantor trust that weren't includible in the gross estate receive a basis adjustment under Section 1014(f). The compliance measures of the Surface Transportation Act don't address this situation because the assets aren't reported on the estate tax return or subject to inclusion in the decedent's estate and therefore fall outside the reach of Sections 1014(f) and 6035.