



Consistent Basis Reporting Update: Treasury Issues Proposed Rules on Portability Returns, Final Values, and After-Discovered Property

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On March 4, 2016, the U.S. Department of the Treasury released both temporary and proposed regulations (the “Proposed Regulations”) on the consistent basis and reporting requirements between a decedent’s estate and persons acquiring property from the decedent. The temporary regulations reiterate the [March 31, 2016](#) due date extension for executors of estates that are required to file Form 8971 before that date. The Proposed Regulations address many of the issues and uncertainties arising from the basis consistency and reporting rules. This alert highlights a few of these issues and the responses found in the Proposed Regulations.

Background and Purpose

On July 31, 2015, President Obama signed into law the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 (P.L. 114-41, 129 Stat. 443) (the “Highway Act”). Section 2004 of the Highway Act enacted new sections 1014(f), 6035, 6662(b)(8), 6662(k), 6724(d)(1)(D), and 6724(d)(2)(II) in the Internal Revenue Code. Essentially, these sections work together to eliminate discrepancies that may arise between how an estate values certain property for purposes of the estate tax and how a recipient of that property reports his or her basis in the property for income tax purposes. To eliminate these potential discrepancies, §6035 of the Code requires an executor of an estate, or other contemplated individual, to accurately report the value of the estate’s property both to the IRS and to the recipient of that property. In effect, this puts all parties, including the IRS, on the same page with respect to the value of certain property acquired from a decedent. These consistent basis and reporting requirements are applicable to all estates filing after July 31, 2015.

Section 1014(f) – The Basis Consistency Requirement

In General

Newly enacted §1014(f) of the Code imposes the basis consistency requirement: a recipient’s basis in property received from a decedent for income tax purposes cannot exceed (i) the property’s value as finally determined for estate tax purposes, if such value has been determined, or, in the alternative, (ii) the value listed on Form 8971. In short, the recipient’s basis in property received from a decedent must be consistent with the value of that property as reported to the IRS.

Property Subject to Basis Consistency

Section 1014(f)(2) and Prop. Reg. §1.1014-10(b)(1) make clear that the basis consistency rules only apply to property that is includible in the decedent's gross estate under §2031, any property that is subject to tax under §2016, and any other property, the basis of which is determined by reference to the basis of the property that generates a tax liability. The Proposed Regulations specifically exclude from the basis consistency requirement property that qualifies for the estate tax charitable and marital deductions under §§2055, 2056, and 2056A, respectively. In addition, the Proposed Regulations take the position that certain tangible property (i.e., tangibles that do not require an appraisal) is "deemed" not to generate an estate tax liability and is, therefore, excluded from the consistency requirement of §1014(f). Finally, it should be noted that, under the Proposed Regulations, if no estate tax is payable because the decedent's gross estate does not exceed available credits, then all property within the decedent's gross estate is excluded from the basis consistency rules. On the other hand, once a decedent's estate exceeds all available credits, the Proposed Regulations state that all property, aside from what is specifically excluded, would be subject to consistent basis rules.

What Constitutes "Final Value?"

For purposes of §1014(f), the value of property has been "finally determined" if the value is: (i) shown on an estate tax return and is not contested by the IRS within the limitations period; (ii) specified by the IRS and is not contested by the executor in a timely manner; or (iii) determined by a court pursuant to a settlement agreement with the IRS. If none of these apply to property received from a decedent, then the final value of the property has not been determined, and the alternative rule then holds that a recipient's initial basis in that property cannot exceed the value reported to the IRS by the executor on Form 8971.

One interesting rule under the Proposed Regulations deals with the "final value" of after-discovered or omitted property and a recipient's basis in that property. What is contemplated here is property that is discovered after, or has been omitted at the time, the estate has closed. Because such property was not part of the estate during the administration period, it does not have a value as "finally determined" for estate tax purposes and has not been reported to the IRS on Form 8971. The language of §1014(f) is silent with respect to such a circumstance. In its place, Proposed Regulation §1.1014-10(c)(3) makes the recipient's basis in such property dependent on whether the executor of the applicable estate has filed an estate tax return under §6018, and whether the executor files a supplemental return with the IRS before the period of limitations for assessment expires.

The best case scenario for a recipient of such property occurs when an estate tax return was filed and, upon learning of the after-discovered or omitted property, the executor files a supplemental return in a timely manner. When this happens, the recipient gets a basis in that property equal to the value reported to the IRS on the supplemental return. The worst case scenario for the recipient occurs when an estate tax return was filed, and the executor fails to file a supplemental return within the assessment period. In this instance, the recipient takes a basis in such property equal to zero.

In situations where an estate tax return was not filed (as in the case that it was not required under §6018), and if the after-discovered or omitted property would have generated or increased the estate's tax liability, the final value of all property of the estate, for purposes of §1014(f), is zero until the executor subsequently files an estate tax return that includes the property or the IRS determines a value for the property.

Section 6035 – The Reporting Requirement

In General

Section 6035 and Prop. Reg. §1.6035-1 impose upon an executor of an estate or other contemplated individuals additional reporting requirements with respect to certain property within that decedent's gross estate. The general rule under §6035 provides that an executor of an estate that is required to file an estate tax return must file (i) an "Information Return" with the IRS reporting the final value of certain property and (ii) a "Statement" with each beneficiary who has acquired or will acquire property from a decedent. The Proposed Regulations define the term "Information Return" as Form 8971, including each beneficiary's schedule, and the term "Statement" as Schedule A of Form 8971.

Portability Returns and Reporting Requirements

It is important to remember that the reporting requirements under §6035 of the Code are imposed only upon executors of estates that, under §6018 of the Code, are required to file an estate tax return. One of the biggest questions concerning these reporting obligations since their inception has been whether such information reporting under §6035 would be required where the executor files an estate tax return solely to elect portability. Greater ambiguity was added under the finalized portability regulations issued in 2015. Under Regulation §20.2010-2(a)(1), an estate that elects portability is "considered" to be required to file a return under §6018. That an estate tax return is "considered to be required" suggests that an executor must also abide by the information reporting rules under §6035 (given that these rules are imposed on estates that are required under §6018 to file estate tax returns). The Proposed Regulations, however, resolve this ambiguity in a very clear manner: per Prop. Reg. §1.6035-1(a)(2) and notwithstanding §20.2010-2(a)(1), the executor does not have to file or furnish the Form 8971 or any schedules if the executor is not required by §6018 to file an estate tax return, even if the executor does so to make the portability election. This same rule applies to executors of estates that file an estate tax return solely to make a GST tax allocation or election or to make any protective filings to avoid any penalty.

Property Subject to Reporting Requirements

Under the Proposed Regulations, the reporting obligations of §6035 of the Code apply to all property reported or required to be reported on an estate tax return. This includes, without limitation, property received in a like-kind exchange, involuntary conversion, or one-half of the decedent's property situated in community property states. Interestingly, the Proposed Regulations only specifically except: (i) cash, (ii) income in respect of a decedent (including IRAs and 401(k) accounts), (iii) tangible personal property for which an appraisal is not required, and (iv) property sold, exchanged, or otherwise disposed of (and therefore not distributed to a beneficiary) by the estate in a transaction in which capital gain or loss is recognized. Property qualifying for the estate tax marital or charitable deduction is not specifically excepted from the reporting requirement, although it is not subject to the basis consistency requirement of 1014(f).

Beneficiaries

As required by the general rule of §6035 of the Code, the executor of an estate must provide to each beneficiary of that estate a Schedule A of Form 8971 that sets forth a description of the property that the beneficiary has received or will receive from the estate. The Proposed Regulations provide rules with respect to specific types of beneficiaries and what to do when a beneficiary cannot be determined or located by the filing due date for Form 8971 and Schedule(s) A. Specifically, the Proposed Regulations provide that , where the beneficiary is an entity, the executor must furnish a Schedule A to the entity and not to the entity's members, shareholders, or individual partners. Likewise, if a beneficiary is a trust or another estate, the executor is to furnish a Schedule A to the trustee or executor of the trust or estate, rather than to the trust's or estate's beneficiaries.

In the event that the executor cannot determine what property will be used to satisfy each beneficiary's interest by the due date for Form 8971, the Proposed Regulations and the instructions to Form 8971 direct the executor to report on the Schedule A for each beneficiary all of the property that the executor could use to satisfy that beneficiary's interest. The Proposed Regulations, but not the instructions to Form 8971, then provide that, once the actual distribution has been made, the executor may, but is not obligated to, make supplemental filings. The instructions to Form 8971, however, state that, in such a situation, "[a] supplemental Form 8971 and corresponding Schedule(s) A should be filed once the distribution to each such beneficiary has been made." Presumably, the Proposed Regulations supersede the instructions to Form 8971 on this point where the IRS, in Notice 2016-19, recommended that, although the instructions had already been published, preparers wait until the proposed regulations were issued before filing the Form 8971. We expect more clarification on this inconsistency in the near future.

As a final note regarding beneficiaries, the Proposed Regulations take the position that an executor "must use reasonable due diligence to identify and locate all beneficiaries." Should the executor be unable to locate a beneficiary by the due date of Form 8971, the Proposed Regulations direct that the executor report this fact on Form 8971 and explain the efforts the executor has made to locate the beneficiary and to satisfy the obligation of reasonable due diligence. Once the executor has located a beneficiary, the executor must then furnish a Schedule A to that beneficiary and make a supplemental filing with the IRS within 30 days of locating the beneficiary. In the event a beneficiary cannot be located and the executor then distributes the property to a different recipient than reported on the original Form 8971, the Proposed Regulations direct the executor to file a supplemental Form 8971 within 30 days from the date the property is distributed to the different beneficiary.

Subsequent Transfers and Additional Reporting Requirements

Interestingly, under the Proposed Regulations as they are now, a recipient of property from a decedent is subject to additional reporting requirements in the event that recipient then distributes or transfers the property, by gift or otherwise, to a related transferee. Once the recipient/transferor transfers the property to a related transferee in a transaction in which the transferee's basis is determined by reference to the recipient/transferor's basis, the recipient/transferor has 30 days from the date of transfer to file a supplemental Statement with the IRS and furnish a copy of the same to the transferee. A related transferee, under the Proposed Regulations, is defined as a member of the transferor's family as defined in §2704(c)(2), any controlled entity, and any trust of which the transferor is deemed owner for income tax purposes.

The Duty to Supplement

The Proposed Regulations affirmatively impose a duty upon executors to file supplemental returns "[i]n the event of any adjustment to the information required to be reported on the Information Return or any Statement." In short, this applies to any change to the information "that causes the information as reported to be incorrect or incomplete," including changes in values of property, changes to the beneficiary to whom the property is to be distributed (i.e., because of death, disclaimer, bankruptcy,

etc.), or discovery of property that should have been reported on an estate tax return. Supplemental Forms 8971 and Schedule(s) A are not required to correct inconsequential errors or omissions within the meaning of Treas. Reg. §301.6722-1(b) or to specify actual distribution of property previously reported as being available to satisfy multiple beneficiaries' interests.

The IRS invited comments to the Proposed Regulations, which are due on June 2, 2016, and it is expected that Final Regulations will be issued thereafter.

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