Estate & Succession Planning Corner

A Basis Misstep

By Lawrence I. Richman

Basis, more particularly the proper reporting of basis, has become a highly important issue for the estate planning community. The enactment of new Code Sec. 1014(f) and the separate reporting requirements under new Code Sec. 6035 as part of the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015[1] have created new legal requirements for uniformity in basis reporting and have led to a compliance regime that imposes new information gathering and reporting burdens upon executors.

It is important, however, neither to lose sight of existing law regarding adjustments to basis for property acquired from a decedent under Code Sec. 1014 nor the fundamental policy provisions of Code Sec. 1014(f). These policy rules state that the basis of certain property acquired from a decedent may not exceed its value as finally determined for estate tax purposes or, if not so determined, then its value as reported on Form 8971 and the accompanying statements as required by Code Sec. 6035. Significantly, since the policy of Code Sec. 1014(f) is to protect the integrity of the estate tax system, the basis consistency rules only apply to property "whose inclusion in the decedent's estate increased the liability for the tax imposed by Chapter 11."[2]

It is the burdensome reporting requirements of Code Sec. 6035, however, which undermine what support there is for the policy goals of Code Sec. 1014(f). Emblematic of those burdens is the requirement that beneficiaries be notified within 30 days of the filing of the estate tax return of the basis of assets that *may* be (as opposed to actually are) distributed to them. In reality, it is more than 30 days after the filing of the estate tax return and more often a year or more before an executor determines what assets are to be distributed or allocated to whom. The 30 days after filing rules are based upon the vague language of Code Sec. 6035(a) requiring executors to report "to each person acquiring any interest in property included in the decedent's gross estate for Federal estate tax purposes a statement identifying the value of each interest in such property." Penalties for failure to comply with the information return filing requirements or the failure to include all information required, or incorrect information, can result in penalties of as much as $3 million "during any calendar year."[3]

The unreasonableness of the mandatory 30-day statutory time frame and the potential impact of the timing strictures of the basis consistency rules are highlighted in a recently released IRS Chief Counsel Advice[4] involving facts that predate the above

LAWRENCE I. RICHMAN is a Partner with Neal Gerber & Eisenberg in Chicago.

 © 2016 CCH INCORPORATED AND ITS AFFILIATES. ALL RIGHTS RESERVED.

described 2015 legislative changes but whose circumstances remain relevant under current law. In CCA 201622032, the IRS considered the application of the mitigation provisions of Code Secs. 1311–1314 to an income tax refund claim. Under the facts presented, the estate's fiduciary used the value of an asset as reported on the decedent's federal estate tax return for purposes of determining its basis. The decedent's estate subsequently disposed of the asset in a transaction in which gain was recognized. That gain was reported on a fiduciary income tax return, Form 1041.

Subsequently, however, the value of the asset as reported on the estate tax return was challenged by the IRS. The determination of value was not resolved at the examination level and resulted in Tax Court litigation. Ultimately, that Tax Court litigation was settled with a stipulated decision document signed by the parties and entered by the

It is the burdensome reporting requirements of Code Sec. 6035, however, which undermine what support there is for the policy goals of Code Sec. 1014(f).

Tax Court. The stipulation adjusted the basis of the asset upwards. Such a basis increase resulted in a reduction in the amount of gain reported on the fiduciary income tax return. By the time the matter was resolved, however, the statute of limitations on the fiduciary income tax return had passed. Thus, the fiduciary was time barred from amending the Form 1041 to report the increase in basis.

Accordingly, the fiduciary sought relief under the mitigation provisions of Code Secs. 1311–1314, presumably under Code Sec. 1312(7), which allows for a corrected computation of income tax liability under Code Sec. 1314 when there has been a prior erroneous recognition of gain. Chief Counsel disagreed that the mitigation provisions applied and recommended that the refund claims submitted by the amended Forms 1041 be denied.

The primary reason for finding the mitigation provisions did not apply to the untimely amended returns was that the litigation concluded with a stipulated decision document signed by the parties and entered by the Tax Court. Chief Counsel concluded that such a stipulation, even though entered by the Tax Court, did not meet the definition of a determination under Code Sec. 1313(a). It reasoned that based upon the decision in *Fruit of the Loom,*[5] a determination "must involve a substantive decision of the merits which establishes that the inconsistent position in the closed year is erroneous."[6] In the instant situation, the decision document met the requirements of the mitigation provisions as to form but failed to do so as to substance in that it did not reflect a decision on the merits. "A settlement agreement does not indicate that the parties agreed on the particular value of the asset; instead, it indicates the parties reached a result both sides felt warranted conclusion of the litigation due to an acceptable result."[7] Thus, according to Chief Counsel, the mitigation provisions should not apply.

Other than avoiding settlement and a stipulated decision by incurring the expense and uncertainty of a trial that results in a litigated decision on the merits which establishes that the inconsistent position in the closed year is erroneous, what should a taxpayer do? First, the new statutory language of Code Sec. 1014(f)(3) should be noted. It provides that basis is considered determined "for purposes of the tax imposed by Chapter 11 if … (C) the value is determined by a court or pursuant to a settlement agreement with the Secretary."[8] Although the new basis consistency provisions are not statutorily integrated with the mitigation provisions, inclusion of settlement agreements as means of supporting basis consistency is important. Ultimately, however, taxpayers should be aware of the possibility of being whipsawed by the income tax statute of limitations when an estate is involved in protracted litigation especially given the fact that the basis consistency rules preclude a taxpayer from using a value for income tax purposes higher than that reported for estate tax purposes. Perhaps, in the instant situation, the stipulated decision could have expressly stated that

the agreement regarding basis applied for both estate and income tax purposes and that the parties and the Court find there to be an erroneous inclusion in gross income in the fiduciary income tax return due to the incorrect basis. With basis consistency an ever increasing matter of import and with the possibility of substantial penalties for a misstep, executors should view the filing of the estate tax return as only a first step in the basis reporting process.

ENDNOTES

1 Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 (P.L. 114-41).

2 Code Sec. 1014(f)(2).

3 Code Sec. 6721(a).

4 CCA 201622032 (Jan. 22, 2016).

5 *Fruit of the Loom, Inc.*, CA-7, 96-1 USTC ¶50,037, 72 F3d 1338, *aff'g* 68 TCM 867, Dec. 50,156(M), TC Memo. 1994-492.

6 CCA 201622032 (Jan. 22, 2016).

7 *Id.*

8 Code Sec. 1014(f)(3).

This article is reprinted with the publisher's permission from the Journal of Passthrough Entities, a bi-monthly journal published by Wolters Kluwer. Copying or distribution without the publisher's permission is prohibited. To subscribe to the Journal of Passthrough Entities or other Wolters Kluwer Journals please call 800-449-8114 or visit CCHGroup.com. All views expressed in the articles and columns are those of the author and not necessarily those of Wolters Kluwer or any other person. © CCH Incorporated. All Rights Reserved.

Wolters Kluwer

 © 2016 CCH INCORPORATED AND ITS AFFILIATES. ALL RIGHTS RESERVED.