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Marketplace
An AALU Washington Report

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The *WRMarketplace* is created exclusively for AALU Members by the AALU staff and Greenberg Traurig, one of the nation's leading tax and wealth management law firms. The *WRMarketplace* provides deep insight into trends and events impacting the use of life insurance products, including key take-aways, for AALU members, clients and advisors.

TOPIC: New Basis Consistency Reporting Legislation – 6 Things to Know.

MARKET TREND: Efforts to increase federal revenue by ensuring consistency in values for estate and income tax purposes may generate more administrative issues than revenue.

SYNOPSIS: The recently enacted Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 implemented new basis consistency requirements for recipients of inherited assets and new information reporting requirements for executors of taxable estates. The basis consistency rules require a beneficiary of an inherited asset to use its estate tax value as its basis for income tax purposes (such as when determining gain from a later sale of the asset). To enforce the new basis rules, executors of taxable estates will need to provide both the recipient of a taxable asset and the IRS with information statements that report the asset's estate tax value; otherwise stiff penalties may apply.

TAKE AWAYS: Both the basis consistency rules and the information reporting requirements are very technical and will likely generate new administrative burdens for estate fiduciaries and beneficiaries. Clients and advisors currently dealing with taxable estates need to pay close attention to future IRS guidance in this area, as the penalties for non-compliance could be significant, especially if the failure to comply is deemed intentional.

MAJOR REFERENCES: *Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 (Pub. L. No. 114-41); IRS Notice 2015-57.*

The recently enacted Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 (the "**Act**") implemented new basis consistency requirements for recipients of certain inherited assets and new information reporting requirements for executors of taxable estates. Although many details remain to be addressed, below are some key items that clients and advisors should know.

1. NEW RULES ARE DRAWN FROM PRESIDENT'S PRIOR BUDGET PROPOSALS

Generally, assets includible in a decedent's estate receive a step-up in income tax basis equal to the estate tax value (i.e., fair market value). Before the Act, however, an inherited asset's estate tax value was only presumptive evidence of its basis in the hands of the beneficiary; under certain circumstances, the beneficiary could attempt to argue that the asset's actual income tax basis was higher than determined for estate tax purposes in effect.

> ***Example:*** Jane inherited real estate from a distant relative, which was assigned a fair market value of $850,000 for estate tax purposes after application of a 15% discount. Jane sells the property 10 years later for $1.5 million but claims her basis should be $1,000,000 (the undiscounted value of the property), which would potentially reduce her gain from $650,000 to $500,000.

The President's recent proposed budgets have included a proposal to eliminate this potential discrepancy by requiring recipients of inherited property to use the estate tax value of that property as the income tax basis. The Act enacts a version of this proposal.

2. THE BASIS CONSISTENCY REQUIREMENT AND THE INFORMATION REPORTNG REQUIREMENT ARE RELATED BUT DIFFERENT

The new legislation involves two separate requirements that apply to different people:

- The "basis consistency requirement" requires <u>recipients of inherited property</u> to report a tax basis consistent with the finally determined estate tax value of the inherited asset (e.g., information typically reported by the recipient on an income tax return after a potentially taxable disposition of the property).[1]

- The "information reporting requirement" requires <u>estate executors</u> to provide "informational statements" that report basis information with regard to estate property to <u>both</u> estate beneficiaries and the IRS.

As described below, there are separate rules and penalties for each requirement.

3. BASIS CONSISTENCY APPLIES ONLY TO PROPERTY GENERATING ESTATE TAX

For the basis consistency requirement to apply to a property recipient, the property must: (1) be acquired from a decedent (i.e., inherited, so the rule does not apply to gifts);[2] <u>and</u> (2) have increased the decedent's estate tax liability when included in the decedent's estate.

Practical Comment: This requirement apparently does <u>not</u> to apply to recipients of assets that qualified for the estate tax marital or charitable deduction or that were covered by the decedent's available federal estate tax exemption. For taxable estates, however, determining the assets where the exemption applied and the assets that generated an estate tax is one of the many issues that will need to be addressed in future regulations.

4. INFORMATION REPORTING APPLIES ONLY IF AN ESTATE TAX RETURN IS REQUIRED

While application of the basis consistency requirement looks at an individual asset, application of the information reporting requirement depends on whether the estate is required to file an estate tax return. For an estate required to file a return,[3] the executor must provide an informational statement to both the IRS and "each person acquiring any interest in property included in the decedent's gross estate," which identifies the value of such property, as reported on the return, and any other information to be required under regulations.[4]

The executor must provide these informational statements no later than 30 days from the due date of the estate tax return (including extensions) or 30 days from when the return is actually filed, if earlier.[5] If there are adjustments to the value of the property or other information reported, revised statements must be provided within 30 days of the adjustment.

Practical Comment: The statute creates a number of questions. For example, if an estate tax return is required merely to elect portability of a deceased spouse's remaining estate tax exemption and not because the estate is taxable, is the executor required to provide informational statements (some commentators have indicated the answer should be no)? Also, complete distribution of an estate can take several years. Other than specific bequests of property, an executor may not know which beneficiaries will receive which estate assets by the due date of the estate tax return. In such a case, must the executor inform every potential beneficiary of the value of every asset not specifically bequeathed? For property passing to a trust, does the executor simply provide the informational statements to the trustee or to every potential trust beneficiary? Presumably, the IRS will address most of these issues in regulations,[6] but for taxable estates, there will certainly be an increase in administrative burdens and costs to meet these requirements.

5. REQUIREMENTS ARE EFFECTIVE IMMEDIATELY BUT INFORMATION REPORTING IS DELAYED TO FEB. 29, 2016

Technically, both the basis consistency requirement and the information reporting requirement became effective for property reported on an estate tax return filed after **<u>July 31, 2015</u>**, even if the decedent died before that date. The IRS, however, must draft new regulations and forms to implement the statute. Thus, in Notice 2015-57, it delayed the deadline for information statements that would otherwise be due from an executor to estate beneficiaries and the IRS until **February 29, 2016**.

Practical Comment: Given the number of unanswered questions, it would be practically impossible for executors to properly comply with the information reporting requirements. Fortunately, Notice 2015-57 specifically states that executors should not file information statements until the issuance of IRS forms or further guidance.

6. SEPARATE PENALTIES APPLY FOR VIOLATING EITHER REQUIREMENT

Basis Consistency Penalties. If the basis consistency requirement applies and a taxpayer reports a basis for inherited property higher than its estate tax value, the accuracy-related penalties applicable to tax underpayments will apply (i.e., 20% of the underpayment amount).[7]

Information Reporting Penalties. The basis informational statements required from executors qualify as information returns for penalty purposes. As of 2016, there will be a $250 penalty for each failure to file a return (capped at $3 million in a calendar year). If the failure is due to intentional disregard, the penalty increases to the **greater of $500 or 10% of the total amount** of items required to be reported.

Practical Comment: These penalties could be substantial, particularly in the case of informational statements if the executor intentionally fails to file several statements for assets with significant values.

TAKE AWAYS

Both the basis consistency rules and the information reporting requirements are very technical and will likely generate new administrative burdens for estate fiduciaries and beneficiaries. Clients and advisors currently dealing with taxable estates need to pay close attention to future IRS guidance in this area, as the penalties for non-compliance could be significant, especially if the failure to comply is deemed intentional.

NOTES

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[1] See Code §1014(f). Note that, per comments by Catherine V. Hughes (Estate and Gift Tax Attorney-Advisor in the Office of Tax Policy of the U.S. Department of the Treasury) at PLI's 46th Annual Estate Planning Institute on Sept. 11, 2015, there may be a technical error in the statute because, as the reported date of death value must be used as the basis, the statute does not appear to allow a recipient of inherited property to increase basis to account for his or her personal contributions to the property. Ms. Hughes said it was unclear whether there would be a technical correction or if the issue would be addressed in regulations.

[2] Within the meaning of Code §1014(a).

[3] Under Code §6018(a).

[4] Code § 6035(a)(1).

[5] Unless an earlier deadline is specified in future regulations.

[6] Per the new statute, the IRS will issue regulations to address application of these rules if no estate tax return is required and in situations involving joint tenants or other recipients who may have more information regarding the inherited property than the executor.
[7] See Code §6662.

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