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AMERICAN BAR ASSOCIATION

Section of Real Property, Trust & Estate Law
321 North Clark Street
Chicago, Illinois 60654-7598
FAX: (312) 988-5262
www.americanbar.org/rpte
E-mail: rpte@americanbar.org

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Room 5203
Internal Revenue Service
PO Box 7604
Ben Franklin Station
Washington, DC 20044.

Internal Revenue Service
eRulemaking Portal at
http://www.regulations.gov
(IRS-REG-127923-15)
CC:PA:LPD:PR (REG–127923–15)

RE: Comments on Proposed Treasury Regulation (Fed. Reg. Vol. 81, No. 43, p. 11486) Doc:) and Temporary Regulations (T.D. 9757) Under Internal Revenue Code Sections 1014 and 6035, Regarding Basis Consistency Between a Recipient's Basis in Certain Property Acquired From a Decedent and the Value of the Property as Finally Determined for Federal Estate Tax Purposes

Ladies and Gentlemen:

We appreciate the opportunity to submit the enclosed comments, questions and recommendations ("the Comments") on behalf of the Section of Real Property, Trust and Estate Law ("RPTE") of the American Bar Association ("ABA") pertaining to the consistency of basis rules under Internal Revenue Code Sections 1014 and 6035. The Comments represent the views of RPTE only and have not been approved by the ABA's House of Delegates or Board of Governors and therefore do not represent and should not be construed as representing the position of the ABA.

The attached submission was prepared by the following members of RPTE: Ryan Walsh, Carl King, Richard Kollauf, Christiana Lazo, Nathan Brown, Carly McKeeman, Sasha Klein, George Karibjanian and Lester Law. These comments were also reviewed by Stephanie Loomis-Price, Richard Franklin and Lester Law on behalf RPTE, and further reviewed by Ellen Harrison on behalf of the RPTE's Committee on Government Submissions ("COGS").

Although the attorneys who participated in preparing these Comments have clients who may be affected by the legal issues addressed by the Comments, no such member (or firm or organization to which any such member belongs) has been engaged by a client to make this submission, or to otherwise influence the development or outcome of the specific subject matter, of these Comments.

RPTE appreciates the opportunity to submit the Comments, and we respectfully request that the Service consider our recommendations. We are available to meet and discuss these matters with the Service and its staff to respond to any questions. The principal contacts for discussion are:

Ryan Walsh – 312.650.8635
Carl King – 704.973.5337
Lester Law – 239.263.4662

Very truly yours,

Robert J. Krapf
Section Chair
ABA Section of Real Property, Trust and Estate Law

Enclosures

AMERICAN BAR ASSOCIATION
SECTION OF REAL PROPERTY, TRUST AND ESTATE LAW

COMMENTS ON PROPOSED AND TEMPORARY TREASURY REGULATIONS RELATING TO CONSISTENT BASIS REPORTING BETWEEN ESTATE AND PERSON ACQUIRING PROPERTY FROM DECEDENT

I. BACKGROUND

The income tax basis of property received from a decedent is generally its fair market value at the decedent's date of death. Internal Revenue Code of 1986 § 1014;[1] Treas. Reg. § 1.1014-3(a).[2] That property's value for estate tax purposes should also be its fair market value at the decedent's date of death. IRC § 2031; Treas. Reg. § 20.2031-1(b). In order to ensure the consistent reporting of estate tax value and basis of that property in the hands of the recipient, Congress enacted, and on July 31, 2015 the President of the United States signed into law, H.R. 3236, the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, Public Law 114–41, 129 Stat. 443 ("Act"). Section 2004 of the Act enacted IRC §§ 1014(f), 6035, 6662(b)(8), 6662(k), 6724(d)(1)(D), and 6724(d)(2)(II).

A. IRC § 1014(f): Basis Consistency Requirement

IRC § 1014(f) imposes an obligation of consistency between the basis of certain inherited property and the value of that property for Federal estate tax purposes.

IRC § 1014(f)(1) provides that basis of property acquired from a decedent cannot exceed that property's final value for purposes of the Federal estate tax imposed on the estate of the decedent, or, if the final value has not been determined, the value reported on a statement required by IRC § 6035(a).

IRC § 1014(f)(2) provides that IRC § 1014(f)(1) only applies to property the inclusion of which in the decedent's gross estate increased the estate's liability for the Federal estate tax (reduced by credits allowable against the tax).

IRC § 1014(f)(3) provides that, for purposes of IRC § 1014(f)(1), the basis of property has been determined for Federal estate tax purposes if: (A) the value of the property is shown on a return under IRC § 6018 and that value is not contested by the Secretary before the expiration of the time for assessing the estate tax; (B) in a case not described in (A), the value

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[1]All references to sections within the Internal Revenue Code of 1986 shall be to the "Code" or "IRC," unless otherwise indicated.

[2]All references to sections of final Treasury regulations shall be to "Treas. Reg. §." References to proposed Treasury regulations shall be to "Prop. Reg. §," and temporary Treasury regulations shall be to "Temp. Reg. §," as the case may be.

is specified by the Secretary and that value is not timely contested by the executor of the estate; or (C) the value is determined by a court or pursuant to a settlement agreement with the Secretary.

IRC § 1014(f)(4) provides, "[t]he Secretary may by regulations provide exceptions to the application of [subsection 1014(f)]."

B. IRC § 6035: Reporting Requirements

IRC § 6035 requires the reporting, both to the IRS and the beneficiary, of the value of property included on a required Federal estate tax return.

IRC § 6035(a)(1) provides that the executor of any estate required to file a return under IRC § 6018(a) must furnish, both to the Secretary and to the person acquiring any interest in property included in the estate, a statement identifying the value of each interest in the property as reported on the return and any other information as the Secretary may prescribe.

IRC § 6035(a)(2) provides that each person required to file a return under IRC § 6018(b) must furnish to the Secretary and to each other person who holds a legal or beneficial interest in the property to which the return relates a statement identifying the information described in IRC § 6035(a)(1).

IRC § 6035(a)(3)(A) provides that this statement is due no later than the earlier of (i) 30 days after the due date of the return under IRC § 6018 (including extensions, if any), or (ii) 30 days after the date the return is filed. If there is an adjustment to the information required to be included on this statement, IRC § 6035(a)(3)(B) requires the executor (or other person required to file the statement) to provide a supplemental statement to the Secretary and to each affected beneficiary no later than 30 days after the adjustment is made.

IRC § 6035(b) provides, "[t]he Secretary shall prescribe such regulations as necessary to carry out [IRC §6035], including regulations relating to (1) the application of [IRC § 6035] to property with regard to which no estate tax return is required to be filed, and (2) situations in which the surviving joint tenant or other recipient may have better information than the executor regarding the basis or fair market value of the property."

C. IRC §§ 6662 and 6724: Penalties

Section 2004(c) of the Act added IRC § 6662(b)(8) which created a new accuracy-related penalty for underpayments attributable to an inconsistent estate basis.

IRC § 6662(k) provides that there is an inconsistent estate basis if the basis of property claimed on a return exceeds the basis as determined under IRC § 1014(f).

Section 2004(c) of the Act adds statements under IRC § 6035 to the list of information returns and payee statements subject to the penalties under IRC §§ 6721 and 6722, respectively. Specifically, the Act adds new paragraph (D) to IRC § 6724(d)(1) to provide that the term information return means any statement required to be filed with the Secretary under IRC § 6035. The Act also adds new paragraph (II) to IRC § 6724(d)(2) to provide that the term payee statement means any statement required to be furnished under IRC § 6035 (other than a statement described in IRC § 6724(d)(1)(D)).

II. COMMENTS, QUESTIONS and RECOMMENDATIONS

The following comments, questions and recommendations (hereinafter, collectively "these Comments") are organized in the order of the proposed Treasury regulations,[3] using the headings contained therein. Subsections for which there are no comments are in brackets.

Prop. Reg. § 1.1014–10 Basis of property acquired from a decedent must be consistent with Federal estate tax return

Prop. Reg. § 1.1014-10(a) Consistent basis requirement

Prop. Reg. § 1.1014-10(a)(1) In general

Issue #1: Extending the Parameters When Consistency Requirements Will Cease

Prop. Reg. § 1.1014-10(a)(1) sets forth the general rule that the taxpayer's basis in property subject to the basis consistency requirement (set forth in Prop. Reg. § 1.1014-10(b)) may not exceed such property's final value (determined in Prop. Reg. § 1.1014-10(c)). The second sentence of Prop. Reg. § 1.1014-10(a)(1) provides that the consistent basis requirement applies until "*the property is sold, exchanged, or otherwise disposed of in one or more transactions that result in the recognition of gain or loss. . . .*" We suggest that the proposed regulations provide that the basis consistency requirement cease to apply if property subject to the consistent basis requirement is later included in another person's estate (i.e., when a new basis consistency requirement will apply).

Issue #2: No Gain / No Loss

Currently, the proposed regulations provide that the basis consistency requirement under IRC 1014(f) will cease to apply when the property is "*sold, exchanged, or otherwise disposed of in one or more transaction that result in the recognition of gain or loss for Federal income tax purposes . . .*" There may be cases where there is no "recognition of gain or loss" simply because the amount realized is equal to the income tax basis, thus, yielding "no gain; no loss."[4] Literally read, the proposed regulations provide that the reporting requirements

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[3] The proposed regulations and the temporary regulations under IRC §§ 1014 and 6035 are identical in wording. For ease or writing and reading, hereinafter, all references will only be to the proposed regulations ("Prop. Reg. §"); however, the comments provided herein would apply to the temporary regulations, too.

[4] This situation is common for assets with little volatility in value sold in traditional "recognition transactions" by an executor soon after death, where the amount realized and the date of death value are the same.

would not apply in situations where an asset is sold and either gain or loss is recognized, but would apply in cases where an asset is sold where the amount realized was equal to the basis and no gain or loss is recognized. This result treats the two different sellers differently; and we recommend that the language be changed to address this inherent unfairness.

Prop. Reg. § 1.1014-10(a)(2) Subsequent basis adjustments.

Issue #1: Post-Death Adjustments Under the Code/Inconsistent with Proposed Regulations

IRC § 1014(f)(1) provides that the basis of any property to which IRC § 1014(a) applies "shall not exceed" the final value of the property determined for purposes of the tax imposed by chapter 11 or (if final value is not determined for purposes of chapter 11) the value furnished on a statement under IRC § 6035(a). IRC § 1014(f)(4) provides that "[t]*he Secretary may by regulations provide exceptions to the application of this subsection*."

IRC § 6662(k) provides:

> *[f]or purposes of this section, there is an 'inconsistent estate basis' if the basis of property claimed on a return exceeds the basis as determined under section 1014(f).*

Prop. Reg. § 1.1014-10(a)(2) provides that adjustments to basis for such items as depreciation, depletion, amortization, capital improvements, basis adjusting events for pass-through entities (e.g., income earned in an S Corporation, distributions from a partnership, etc.), and other items that affect basis under some provision of tax law, will not cause basis to be inconsistent to the extent of such adjustments.

Prop. Reg. § 1.6662-8(b) provides,

> *there is an inconsistent estate basis to the extent that a taxpayer claims a basis, without regard to the adjustments described in § 1.1014-10(a)(2), in property . . . that exceeds the property's final value as determined under § 1.1014-10(c).*

The language underlined in the quote, "without regard to the adjustments described in § 1.1014-10(a)(2)," is not clear. We offer the following suggested language instead: "before taking into consideration the adjustment described in § 1.1014-10(a)(2,)."

We suggest issuance of regulations for the penalty provisions in IRC § 6662 to clarify that the basis adjustments under Prop. Reg. § 1.1014-10(a)(2) also will be taken into consideration in cases where the Internal Revenue Service[5] wishes to impose a penalty under IRC § 6662.

[5]Reference to the Internal Revenue Service will sometimes be to the "IRS" or "Service."

<u>Prop. Reg. § 1.1014-10(b) Property subject to consistency requirement</u>

<u>Prop. Reg. § 1.1014-10(b)(1) In general</u>

<u>Issue #1:</u> Inclusion under IRC § 2031

IRC § 1014(f)(2) provides that the basis consistency requirements:

> *. . . only apply to any property whose inclusion in the decedent's estate increased the liability for the tax imposed by Chapter 11 (reduced by credits allowable against such tax) on such estate.* [emphasis added]

Prop. Reg. § 1.1014-10(b)(1) is slightly different from the Code provision, which states that property subject to the basis consistency requirements includes:

> *. . . any property that is includable in the decedent's gross estate <u>under section 2031</u>, any property subject to tax under section 2106, and any other property the basis of which is determined in whole or in part by reference to the basis of such property (for example as the result of a like-kind exchange or involuntary conversion) that generates a tax liability under chapter 11 of subtitle B of the Code (chapter 11) on the decedent's estate in excess of allowable credits, <u>except the credit for prepayment of tax under chapter 11</u>.* [emphasis added]

We respectfully suggest that the reference to IRC § 2031 in the proposed regulations be changed. IRC § 2031 provides that the value of a decedent's gross estate shall be determined by including the total value of all interests includable in a decedent's gross estate under IRC §§ 2033-2044. IRC § 2031 does not itself result in the inclusion of any assets in a decedent's gross estate. Rather, IRC § 2031 defines the term "gross estate" by reference to other provisions of the Code (i.e., IRC §§ 2033-2044, inclusive) that result in certain assets being included in a decedent's gross estate. Because IRC § 2031 does not result in the inclusion of any assets in a decedent's gross estate, we respectfully propose that the phrase "any property that is includable in the decedent's gross estate under section 2031" be replaced with "any property the value of which is required to be included in determining the value of the decedent's gross estate under section 2031."

<u>Issue #2:</u> Reference to IRC § 2106

Prop. Reg. § 1.1014-10(b)(1) provides that ". . . any property *subject to tax under section 2106* . . . " is subject to the basis consistency requirements. IRC § 2106 defines the term "taxable estate" with respect to nonresident non-US citizens by specifying allowable deductions. It does not impose a tax or define the gross estate. We respectfully recommend that the phrase "subject to tax under section 2106" be replaced with "the value of which is required to be included in determining the value of the decedent's gross estate under section 2031."

<u>Issue #3:</u> Payment of Tax Credit

In determining whether property included in a decedent's gross estate generates an estate tax liability, the parenthetical language in IRC § 1014(f)(2) provides that the estate is allowed to reduce any potential estate tax liability by "*credits allowable against such tax.*" Prop. Reg. § 1.1014-10(b)(1) provides that property is subject to the basis consistency requirements to the extent that the inclusion of such property in the decedent's gross estate:

> *generates a tax liability under chapter 11 of subtitle B of the Code (chapter 11) on the decedent's estate in excess of allowable credits, <u>except the credit for prepayment of tax under chapter 11</u>.*

Chapter 11 of the Code sets forth six (6) operative provisions regarding credits for estate tax, as follows:

- the applicable exclusion credit (formerly known as the "unified credit") under IRC § 2010;
- the credit for gift taxes paid under IRC § 2012;
- the credit for tax paid on prior transfers under IRC § 2013;
- the credit for foreign death taxes under IRC § 2014;
- the credit for death taxes on remainders under IRC § 2015; and
- the recovery of foreign taxes claimed as a credit under IRC § 2016.

However, there is no credit for the "*<u>prepayment of tax under chapter 11.</u>*" We respectfully recommend that the last clause (i.e., "*except the credit for prepayment of tax under chapter 11*") either (a) be removed, or (b) be revised to clarify the Service's intent regarding which credits are to be taken into consideration in determining whether assets included in the decedent's gross estate generate an estate tax liability.

<u>Prop. Reg. § 1.1014-10(b)(2) Exclusions</u>

<u>Issue #1:</u> Clarification for the Exception for Certain Tangible Personal Property

The preamble to the proposed regulations (the "Preamble") notes that Treasury wanted to be practical about certain lower-valued tangible personal property, where an appraisal would be unnecessary to exempt such property from the basis consistency rules. Specifically, the Preamble states:

> *In addition, the proposed regulations exclude any tangible personal property for which an appraisal is not required under § 20.2031-6(b) (relating to the valuation of certain household and personal effects) because of its value.*

It appears that Treasury's intent was to exclude "household and personal effects articles having a marked artistic or intrinsic value of a total value" less than or equal to $3,000 from being subjected to the basis consistency rules. We are not sure that the language of the proposed regulations accomplishes this intent.

Prop. Reg. § 1.1014-10(b)(2) states:

> *For purposes of paragraph (b)(1) of this section, <u>tangible personal property</u> for which an appraisal is not required under § 20.2031-6(b) is deemed not to generate a tax liability under chapter 11 and therefore also is excluded from the property subject to the consistency requirement in paragraph (a)(1) of this section.* [emphasis added]

We also note that Treas. Reg. § 20.2031-6(b) reads, in part, as follows:

> *(b) Special rule in cases involving a substantial amount of valuable articles. Notwithstanding the provisions of paragraph (a) of this section, if there are included among the <u>household and personal effects articles</u> having marked artistic or intrinsic value of a <u>total value</u> in excess of $3,000 (e.g., jewelry, furs, silverware, paintings, etchings, engravings, antiques, books, statuary, vases, oriental rugs, coin or stamp collections), the appraisal of an expert or experts, under oath, shall be filed with the return. . . .* [emphasis added]

Prop. Reg. § 1.6035-1(b)(2)(Example 1) provides the following example:

> *Example 1. Included in D's gross estate are the contents of his residence. Pursuant to § 20.2031–6(a), the executor attaches to the return required by section 6018 filed for D's estate a room by room itemization of household and personal effects. All articles are named specifically. In each room a number of articles, none of which has a value in excess of $100, are grouped. A value is provided for each named article. <u>Included in the household and personal effects are a painting, a rug, and a clock, each of which has a value in excess of $3,000</u>. Pursuant to § 20.2031–6(b), the executor obtains an appraisal from a disinterested, competent appraiser(s) of recognized standing and ability, or a disinterested dealer(s) in the class of personalty involved for the painting, rug, and clock. The executor attaches these appraisals to the estate tax return for D's estate. Pursuant to paragraph (b)(1)(iii) of this section, the reporting requirements of paragraph (a)(1) of this section apply only to the painting, rug, and clock.* [emphasis added]

The term "tangible personal property" in Prop. Reg. § 1.1041-10(b)(2) is much broader than the property enumerated in Treas. Reg. § 20.2031-6(b). The former says that the exclusionary rule applies to "tangible personal property," where the latter applies to "household and personal effects." One could argue that if you have tangible personal property that is not considered a "household" article or "personal effect" and because reporting is not required under Treas. Reg. § 20.2031-6(b), which only covers household items and personal effects, no reporting is required under section 6035.

We respectfully suggest a modest change to the provision for clarity, and we offer the following alternative language, based on our comments above, for your review and consideration:

> *For purposes of paragraph (b)(1) of this section, household and personal effect for which an appraisal is not needed (as provided for under § 20.2031-6(b)) are deemed not to generate a tax liability under chapter 11 and therefore also is excluded from the property subject to the consistency requirement in paragraph (a)(1) of this section.*

Or, alternatively,

> *For purposes of paragraph (b)(1) of this section, each item of tangible personal property having a value of less than $3,000 is deemed not to generate a tax liability under chapter 11 and therefore also is excluded from the property subject to the consistency requirement in paragraph (a)(1) of this section.*

We further suggest that the $3,000 limit is arbitrary, artificially low, and quite outdated.

<u>Issue #2:</u> Property that Qualifies for the Marital Deduction Under IRC § 2056

The Preamble states,

> *In cases where Federal estate tax is imposed on the estate, the proposed regulations exclude property that qualifies for a charitable or marital deduction under section 2055, 2056, or 2056A because this property does not increase the Federal estate tax liability.*

Consistent with the Preamble, Prop. Reg. § 1.1014-10(b)(2) states,

> *For purposes of paragraph (b)(1) of this section, property that <u>qualifies for</u> an estate tax charitable or <u>marital deduction</u> under section 2055, <u>2056, or 2056A</u>, respectively, does not generate a tax liability under chapter 11 and therefore is excluded from the property subject to the consistency requirement in paragraph (a)(1) of this section.*

A technical argument could be made that the statement is not entirely correct, as it applies to all property eligible for the marital deduction and is not limited to property that in fact qualified for the marital deduction. Technically, a qualified domestic trust (sometimes called a "QDOT") and a qualified terminable interest property trust (sometimes called a "QTIP Trust") both "qualify" for the marital deduction; however, an election (under IRC § 2056A(a)(4) and (d) for a QDOT, and 2056(b)(7) for a QTIP Trust) must be made to obtain the marital deduction. Thus, it is entirely possible for a trust to qualify for the marital deduction, but if no election has been made, there would be no marital deduction. Thus, it is possible for such trust (which qualified for the marital deduction, but did not elect) to generate an estate tax liability. Therefore, to be consistent with the intent of this provision, we respectfully suggest that only those trusts for which the marital deduction is allowed be excluded. This provision might be clarified by substituting "qualified" for "qualifies."

[Prop. Reg. § 1.1014-10(b)(3) Application]

We have no comments.

Prop. Reg. § 1.1014-10(c) Final value

Prop. Reg. § 1.1014-10(c)(2) No finality of estate tax value

Issue #1: Perceived Unfairness

IRC § 1014(f)(1) and Prop. Reg. § 1.1014-10(c)(2) set the maximum basis of property acquired from a decedent or to whom the property passed from a decedent to be either (a) the finally determined amount, or (b) the amount reported on the statement to be provided to the IRS and the beneficiary under IRC § 6035 (which is generally the value reported on the Federal estate tax return (sometimes herein referred to as the "Form 706")).

Prop. Reg. § 1.1014-10(c)(2) provides that if the "final value" of property "differ[s] from" the value reported on the statement originally furnished to the beneficiary pursuant to IRC § 6035 (i.e., "Schedule A" to Form 8971), the beneficiary may not rely on the value set forth on Schedule A and "may have a deficiency and underpayment resulting from the difference in value" if the beneficiary reported a transaction using a higher value set forth on the original Schedule A as the basis of the property.

This situation may be unfair to taxpayers, especially where the sale by the taxpayer occurred before the final value for estate tax purposes was determined. Even where the sale occurred after the final value was determined, penalties should be waived if the taxpayer did not receive a revised information return from the executor and otherwise acted in good faith.

Issue #2: Open Income Tax Years

In light of the maximum basis limit set forth in IRC § 1014(f)(1), the Preamble provides,

> *. . . proposed § 1.1014-10(c)(2) provides that, if final value is determined before the period of limitation on assessment expires for any Federal income tax return of the recipient on which the taxpayer's basis is relevant and the final value differs from the initial basis claimed with respect to that return, a deficiency and underpayment may result.*

The Preamble acknowledges that a deficiency and underpayment may result with respect to a beneficiary only if a final value is determined before the period of limitations on assessment expires on the beneficiary's Federal income tax return reporting the transaction using the value set forth on the statement as the basis of the property. Prop. Reg. § 1.1014-10(c)(2), however, merely states that a deficiency and underpayment "***may result***" if the final value is subsequently determined to be different from the original Schedule A value. Prop. Reg. § 1.1014-10(c)(2) contains no reference to the limitations period with respect to the income tax return of the recipient on which the basis is relevant. We recommend that the final regulations affirm that they do not affect the application of the statute of limitations on assessment on the beneficiary's Federal income tax return reporting the transaction in which the value set forth on the statement was used as the basis of the property.

[Prop. Reg. § 1.1014-10(c)(3) After-discovered or omitted property]

We have no comments.

Prop. Reg. §1.1014-10(c)(3)(i) – Return under IRC § 6018 Filed

Issue #1: Property Described in (b)(1)

Prop. Reg. § 1.1014-10(c)(3)(i) applies to property described in Prop. Reg. § 1.1014-10(b)(1). Prop. Reg. § 1.1014-10(b)(1) is the general inclusion provision that describes the universe of property that is initially subject to the basis consistency rules. However, Prop. Reg. § 1.1014-10(b)(2) excepts certain property (i.e., charitable, marital and lesser valued tangible personal property, discussed above) from the basis consistency rules. We respectfully request that Prop. Reg. § 1.1014-10(c)(3)(i) be clarified to make it clear that it is limited to property described in Prop. Reg. § 1.1014-10(b)(1) that is not otherwise excluded under Prop. Reg. § 1.1014-10(b)(2).

We respectfully request that an example be provided to demonstrate that the excluded property under Prop. Reg. § 1.1014-10(b)(2) would not be subject to the zero basis rule.

<u>Issue #2:</u> Returns "Required to be Filed" Under IRC § 6018

Prop. Reg. § 1.1014-10(c)(3)(i) sets forth certain rules for so-called "after-discovered" or "omitted" property (which is referred to in these Comments as "unreported property").[6] Prop. Reg. §§ 1.1014-10(c)(3)(i) and (ii) provide different rules depending on whether a Form 706 is filed pursuant to IRC § 6018. We request that the Treasury clarify that Prop. Reg. § 1.1014-10(c)(3) only applies when a return is required to be filed under IRC § 6018, as distinguished from a return that is filed optionally, including one solely for purposes of making the portability election under IRC § 2010(c)(5)(A).

<u>Prop. Reg. § 1.1014-10(c)(3)(i)(A) – Reporting Prior to Expiration of Period of Limitation on Assessment</u>

<u>Issue #1:</u> Initial Return

Prop. Reg. § 1.1014-10(c)(3)(i) begins with the premise that a Form 706 has been filed. Thereafter, Prop. Reg. § 1.1014-10(c)(3)(i)(A) provides that the final value of unreported property will be determined in accordance with Prop. Reg. § 1.1014-10(c)(1) or (2) if:

> *the executor, prior to the expiration of the period of limitation on assessment of the tax imposed on the estate by chapter 11, files with the IRS an <u>initial</u> or supplemental estate tax return.*

Because Prop. Reg. § 1.1014-10(c)(3)(i) contemplates that a return was already filed, we find it difficult to envision how filing supplemental information could be "an initial" return. We respectfully suggest that the words "initial" and "or" should be removed from that sentence and the word "an" be changed to "a," such that the last clause reads ". . . files with the IRS a supplemental estate tax return."

<u>Prop. Reg. § 1.1014-10(c)(3)(i)(B) – No Reporting Prior to Expiration of Period of Limitation on Assessment</u>

<u>Issue #1:</u> Authority for Zero Basis for Unreported Property

Prop. Reg. § 1.1014-10(c)(3)(i)(B) provides that if the executor files a Form 706 and does not report property that was otherwise to be reported on a Form 706 (i.e., unreported property) prior to the expiration of the period of limitation on assessment of the tax imposed on the estate by chapter 11 (the "estate's statute of limitations"), the final value of such unreported property is zero ($0). It should be noted that the burden that this provision places on the executor to "amend" or "supplement" Form 706 that was filed in good faith does not seem to have a foundation in law. Additionally, there does not appear to be a duty

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[6] Note: We discuss below why it may be better to use the term "unreported property" instead of "after-discovered" or "omitted" property.

to file an amended estate tax return if one was filed in good faith. *See Badaracco v. Comm'r*, 464 U.S. 386 (1984) (amended estate tax return is "a creature of administrative origin and grace" and is not required by statute).

We respectfully question, as a preliminary matter, whether there is authority to provide that unreported assets receive a zero basis. Importantly, IRC § 1014(a) provides that the basis of property received from a decedent is generally the property's fair market value at the time of death (the "date-of-death value"). Filing a Form 706 is not a prerequisite to obtaining the date-of-death value. This is true for estates where the gross estate is less than or equal to the decedent's basic exclusion amount (adjusted for taxable gifts) and the estate is not otherwise required to file a Form 706 (e.g., for portability). Thus, IRC § 1014(a) simply states that the basis in the hands of the beneficiary is the date-of-death value. IRC § 1014(f) was designed to enforce the rule that the beneficiary may not claim a basis higher than the date-of-death value.

The proposed regulations go farther than the statute and reduce the basis below its date of death value to $0. It appears that this was not the intent of the statute. Presumably, the purpose of the basis consistency regulations was not to capture taxpayers who were not reporting their assets on the estate tax return; rather it was to capture taxpayers who used a basis on the income tax return higher than that on the estate tax return, where the basis increase was not due to a valid tax reason (e.g., a capital contribution, addition, etc.).

The issue of zero basis is also problematic and may be unfair to certain taxpayers and not others. For instance, consider the following examples. In the first example, the decedent died in 2016 with a gross estate of $5,449,999 leaving all of his assets to his only child. In this case, none of the assets is subject to the basis consistency rules. The basis of the assets will be the date-of-death value. Second, the decedent dies in 2016 with the same gross estate of $5,449,999, leaving his entire estate to his child, where the taxpayer does not file a Form 706. Let us assume that property is thereafter discovered worth $10,000 (but not reported). In this case, all of the property has a zero basis. The difference of ten thousand dollars, less than two one-hundredths of one percent (i.e., $10,000 / $5.45 million) causes a zero-basis versus a date-of-death value basis for *all property* in the estate.

The specific authority granted by Congress to Treasury to promulgate regulations under IRC § 1014(f) is provided in IRC § 1014(f)(4) and only allows regulations to "provide exceptions to the application of" IRC § 1014(f). We respectfully request that the zero basis rules be removed, as Treasury has no clear authority to determine a basis of zero in the hands of a recipient where value can be established in the hands of a decedent.

<u>Issue #2:</u> Zero Basis – Timely Filing

Assuming that Treasury believes that it has authority to have a zero basis rule, in many circumstances the beneficiary may have no control over the filing of a Form 706 or Schedule A. For instance, an executor responsible for filing a Form 706 who does not file leaves the statute of limitations open, such that a Form 706, albeit late, could be filed at a later date.

That same executor who, in good faith, files a required Form 706 causes the statute of limitations to begin to run and under these proposed regulations burdens recipients with a zero basis in property discovered after the statute of limitations has run. The penalties for inconsistent basis reporting fall on the beneficiary who subsequently reports a transaction for which the basis of property subject to IRC § 1014 is relevant. It appears unfair for the beneficiary to suffer for the failure of a decedent's executor to properly file a return under IRC § 6018 or to correct that return with respect to the unreported property.

Issue #3: Zero Basis – Cash

Assuming that Treasury believes that it has the authority to have a zero basis rule, a question arises if the unreported property is cash. Posit the situation where, after a Form 706 is filed and the statute of limitations has expired, the executor finds a significant amount of cash in the decedent's house (years later). Under Prop. Reg. § 1.1014-10(c)(3)(i)(B), the basis of that cash would be zero. We respectfully request that an exception be made for cash, because it does not appear that the basis of cash can be anything other than its face value (and thus, not zero).

Prop. Reg. § 1.1014-10(c)(3)(ii) – No Return Under IRC § 6018 Filed

Issue #1: Authority for Zero Basis in Unreported Property

As discussed above in Prop. Reg. § 1.1014-10(c)(3)(i)(B), where we respectfully question Treasury's authority to have a zero basis rule, we respectfully ask the same question under Prop. Reg. § 1.1014-10(c)(3)(ii), for the same reasons.

Issue #2: Zero Basis in Cash

Assuming that Treasury believes it has the authority to have a zero basis rule, as discussed above in Prop. Reg. § 1.1014-10(c)(3)(i)(B), where we respectfully request an exception for cash, we respectfully request the same exception in Prop. Reg. § 1.1014-10(c)(3)(ii).

Issue #3: How Can there be Omitted Property - If a Return Was Never Filed?

Prop. Reg. § 1.1014-10(c)(3)(ii) states as follows:

> *(ii) No return under section 6018 filed. If no return described in section 6018 has been filed, and if the inclusion in the decedent's gross estate of the after-discovered or omitted property would have generated or increased the estate's tax liability under chapter 11, the final value, for purposes of section 1014(f), of all property described in paragraph (b) of this section is zero until the final value is determined under paragraph (c)(1) or (2) of this section. Specifically, if the executor files a return pursuant to section 6018(a) or (b) that includes this property or the IRS*

> *determines a value for the property, the final value of all property described in paragraph (b) of this section includible in the gross estate then is determined under paragraph (c)(1) or (2) of this section.* [emphasis added]

It is incorrect to say that property was "omitted" from a return that was never filed. If the return was never filed, then the property could not have been omitted because there was nothing from which to be omitted. Accordingly, we suggest the use of the term "unreported property" (for purposes of Prop. Reg. § 1.1014-10(c)(3)(i) and (ii)), because it better describes the property, being that it is property that should have been reported on the Form 706 but was not reported (for whatever reason).

We also suggest that "after-discovered" property be simply incorporated into the concept of "unreported property."

We respectfully offer the following suggested language for Prop. Reg. § 1.1014-10(c)(3)(i) for your review and consideration:

> *(3) Unreported property—(i) Return under section 6018 filed. In the event property described in paragraph (b)(1) of this section should have been reported on an estate tax return under section 6018 that has been filed but was not reported (unreported property), the final value of that property is determined under section (c)(3)(i)(A) or (B) of this section.*

We suggest also using the term "unreported property" instead of "after-discovered or omitted property" in Prop. Reg. §§ 1.1014-10(c)(3)(i)(A), -10(c)(3)(i)(B), and -10(c)(3)(ii).

<u>Issue #4:</u> Consistency in language between Prop. Reg. § 1.1014-10(c)(3)(ii) and Prop. Reg. § 1.1014-10(c)(3)(i)

As discussed above, we believe that Prop. Reg. § 1.1014-10(c)(3)(i) should exclude property described in Prop. Reg. § 1.1014-10(b)(2). Assuming that such change is made, we respectfully request that Treasury consider making the same change to Prop. Reg. § 1.1014-10(c)(3)(ii) so that the two provisions (i.e., Prop. Reg. § 1.1014-10(c)(3)(i) and -10(c)(3)(ii)) are congruous.

<u>Issue #5:</u> Zero Basis Could, But Should Not, Apply to Excluded Property

As discussed above, we believe that Prop. Reg. § 1.1014-10(c)(3)(i) should exclude property described in Prop. Reg. § 1.1014-10(b)(2); likewise, we believe that Prop. Reg. § 1.1014-10(c)(3)(ii) should exclude property described in Prop. Reg. § 1.1014-10(b)(2).

Prop. Reg. § 1.1014-10(c)(3)(ii) states, in part, as follows:

> (ii) No return under section 6018 filed. If no return described in section 6018 has been filed, and if the *inclusion in the decedent's gross estate of the after-discovered or omitted property would have generated or increased the estate's tax liability under chapter 11, the final value, for purposes of section 1014(f), of all property described in paragraph (b) of this section is zero until the final value is determined under paragraph (c)(1) or (2) of this section.*

Prop. Reg. § 1.1014-10(c)(3)(ii) should exclude the property described in Prop. Reg. § 1.1014-10(b)(2). It excludes charitable property because, if the unreported property qualified for the charitable deduction, the property would not cause an increase in the Federal estate tax liability for the estate. Similarly, assuming that the "marital deduction" language is addressed (discussed above with regard to QDOTs and QTIP trusts), unreported property that was subject to the marital deduction would not increase the estate tax liability. However, there is a third group of property, namely, certain lower valued (i.e., less than $3,000 in value) tangible personal property that is specifically excluded under Prop. Reg. § 1.1014-10(b)(2) that would get caught in the zero basis rule where it would have otherwise been outside of the basis consistency rules under IRC § 1014(f). Accordingly, we respectfully request that Prop. Reg. § 1.1014-10(c)(3)(ii) be changed to take this issue into consideration.

We respectfully request that an example be given to demonstrate that the excluded property under Prop. Reg. § 1.1014-10(b)(2) would not be subject to the zero basis rule.

Comments, Questions and Observations for the Zero Basis Rule

Deadlines for Filing Form 706 and Supplemental Statements

Prop. Reg. § 1.1014-10(c)(3)(ii) appears to allow the filing of a return after property is discovered that would have generated or increased the estate's tax liability under chapter 11 for purposes of determining final value. What is the deadline to file such a return?

Inconsistent Treatment of Taxpayers – Incentive Not to File Form 706

If a Form 706 was required but not filed, it appears there is still an opportunity to prevent the zero basis rule from applying. Prop. Reg. § 1.1014-10(e)(example 2) supports that conclusion. Thus, not filing yields a better result than if the return had been timely filed in the first place if unreported property is discovered after it is too late to file a supplemental return. It seems that filing the return properly in the first instance should not prejudice the executor (or the recipients of the property) with respect to unreported property.

This situation creates an incentive for taxpayers not to file a return. For example, in cases where an estate is close to but not over the decedent's exclusion amount, for purposes of preventing the zero basis rule from applying to *all* property includible in the estate upon the later discovery of assets, the beneficiaries might be better off if an estate tax return is not filed.

How does this rule apply when a return is not required but nevertheless is filed? For example, suppose a portability-only return is filed for an estate of a decedent who died in January 2015 with assets valued at $4,500,000. An after-discovered asset worth $1,000,000 is found 3 years, 2 months after the estate tax return is filed, thereby causing the executor to now have a required filing under IRC § 6018. However, the 3 year statute of limitations has passed on the return that was filed (and value is less than 25% so the 6 year statute does not apply).Does the filing of a portability only or protective return prevent the filing of an amended return more than three year later? The portability regulations state that an estate that elects portability will be "considered . . . to be a required to file a return under 6018(a)" in order to subject such return to the due date otherwise applicable to returns required to be filed under IRC § 6018(a). The basis consistency proposed regulations state that portability only returns are not subject to IRC § 6035 reporting requirements. Prop. Reg. § 1.6035-1(a)(2). Does this mean that the portability only return is ineffectual, such that the statute of limitations has not yet run? If not, it appears that if a portability return is filed but then after-discovered property puts an estate over the exemption and causes a tax, then all after-discovered or omitted property on the return (other than marital deduction property?) has a zero basis; but if the return was not filed, there would be an opportunity to correct by filing a return after the omitted property is discovered.

<u>Prop. Reg. § 1.1014-10(d) Executor</u>

See comments under Prop. Reg. § 1.6035-1(g)(1) below.

<u>Prop. Reg. § 1.1014-10(e) Examples</u>

See comment below in Prop. Reg. § 1.6035-1(a) regarding assets that are subject to non-recourse debt reported on net asset value (i.e., the equity of redemption) on the Form 706 and how such property should be reported under IRC § 6035.

<u>Prop. Reg. § 1.1014-10(f) Effective/applicability date</u>

<u>Issue #1:</u> Supplementing an Originally Filed Estate Tax Return

The Act provides that the basis consistency rules set forth in IRC § 1014(f) apply to "property with respect to which an estate tax return is filed after the date of the enactment of this Act." P.L. 114-41, Section 2004(d). The Act was signed into law on July 31, 2015. Thus, a literal reading of the law provides that the basis consistency rules would apply to "all property" with respect to which an estate tax return is filed after July 31, 2015.

We respectfully request clarification as to whether the filing of supplemental information to an originally filed Form 706 is considered "an estate tax return" for purposes of this provision. We do not believe this to be the case and respectfully request confirmation. For example, assume Decedent died on February 15, 2014, and his estate tax return was filed on its extended due date of May 15, 2015. Assuming no supplemental returns were necessary, because the estate tax return was filed before July 31, 2015, the basis consistency rules and the reporting requirements do not apply to the executor of Decedent's estate or to those who receive property as a result of Decedent's death. If Decedent's estate tax return was filed late, after July 31, 2015, the estate tax return was filed after July 31, 2015, and the basis consistency rules and reporting requirements would apply.

However, assume that Decedent's estate tax return was timely filed on May 15, 2015, but as a result of unreported property, supplemental information was filed after July 31, 2015. It is unclear from the proposed regulations whether filing such "supplemental information" is an "estate tax return" for purposes of the application of the Act.

To be clear, we respectfully request that Treasury confirm that the filing of supplemental information after July 31, 2015, with regard to an originally, timely-filed Form 706 filed before July 31, 2015, will not subject any of the assets on the originally filed Form 706 (as supplemented) to the basis consistency rules.

<u>Prop. Reg. §1.6035-1 Basis information to persons acquiring property from decedent</u>

<u>Prop. Reg. § 1.6035-1(a) Required Information Return and Statement(s)</u>

<u>Prop. Reg. § 1.6035-1(a)(1) In general</u>

As we discuss below, President Obama's Administration ("the Administration") desired to implement the basis consistency rules to certain property transferred at the death of a decedent and to implement complementary reporting rules to buttress the consistency rules. We respectfully submit that the reporting requirements set forth under Prop. Reg. § 1.6035-1 are unduly burdensome on the executors of estates.

Although the IRS estimates that the total time to comply with the rules will be roughly 5 ½ hours per estate (according to the instructions to the Form 8971),[7] anecdotal and informal information indicate that these estimates are extraordinarily low. Informal polls of practitioners who specialize in estate planning and administration reflect significantly more hours necessary for record-keeping and preparation and assembly of the form and schedules. The work necessary to comply with Prop. Reg. § 1.6035-1 would likely take closer to 20–50 hours, depending upon the facts of individual estates. This time estimate does not include the multiple subsequent Schedules A that might later be required as highlighted in our example under "Additional Comments," in the comments to Prop. Reg. § 1.6035-1(f) below. Form 8971 and Schedule A will be required to be filed for all estates required to file a Form 706 and not only for those returns that show a tax due and/or hold assets subject to the basis consistency rules; the burden to estates to provide information to the IRS and the beneficiaries will be costly relative to the benefit to the fisc to providing such information.

[7]The Form 8971instructions state that it would take approximately 3 hours and 49 minutes to keep records, 42 minutes to learn the law or the form and 47 minutes to prepare, assemble and send the form to the IRS.

Furthermore, we understand that Treasury's duty in administering tax statutes includes providing reasonable and efficient tax administration. At an average rate of $250 per professional hour, for 20-50 hours of compliance work per report, multiplied by 10,000 anticipated returns (estimate from Instructions to Form 8971), annual compliance costs will range from $50,000,000 to $125,000,000, exclusive of ongoing reporting on Schedules A under Prop. Reg. § 1.6035-1(f). These costs are staggering, compared to the Congressional Budget Office estimate of $150 million annually to be raised by these provisions. Trusts and estates practitioners do not view these proposed regulations as a new practice area, a profit center or a business opportunity. Rather, there is legitimate concern of taxpayer-client's frustration with excessive reporting obligation, which is especially true in cases where the basis consistency rule does not apply to those assets. Additionally, in the long run, there is concern with the integrity of the voluntary tax compliance system. Respectfully, we suggest that the Treasury consider a different approach regarding the administration of IRC §§ 1014(f) and 6035, focusing on streamlining and substantially reducing compliance costs. Such a streamlined approach would adhere to the spirit of the law (which is to achieve basis consistency for those asset that are subject to the rules under § 1014(f)). Reliance primarily upon the preexisting and long-established duty of taxpayers (i.e., asset recipients) to provide credible evidence of basis, rather than upon extensive information reporting by transferors, is a helpful guiding principle toward a simpler and reasonably efficient system of compliance.

Prop. Reg. § 1.6035-1(a)(2) Exception

We are pleased the Prop. Reg. § 1.6035(a)(1) clarifies that § 1.6035-1(a)(2) only applies to estates required to file a Form 706.

Issue #1: Protective Filings, etc.

Prop. Reg. § 1.6035-1(a)(2) provides that IRC § 6035 only applies to estates required to file a return and not to estates where an executor makes a filing for generation-skipping transfer tax purposes, to elect portability or to avoid any penalty if an asset value is later determined to cause a return to be required. In such instances, as contemplated by Prop. Reg. § 1.1014-10(c)(3)(i) where property is discovered after the estate tax return has been filed, the opportunity to correct the basis reporting may be lost after the period of limitation expires on a protective return. We respectfully request that Treasury clarify whether an amended return may be filed for purposes of establishing basis where an estate tax return was filed voluntarily (e.g., to elect portability) but was not required to be filed, so that the estate may avoid application of the zero basis rule by filing an amended return even after the due date that would have applied had a return been required.

Prop. Reg. § 1.6035(b) Property for which reporting is required

Prop. Reg. § 1.6035-1(b)(1) In general

IRC § 6035 provides that property to be reported on Form 8971 and Schedule A shall be property that was included on Form 706. Prop. Reg. § 1.6035-1(b)(1) goes further to require that the property reported also includes property that may no longer be in the estate, but that may have been exchanged (in a tax-free or partially tax free transaction), where the basis of such new property is determined in whole or in part by reference to the property originally reported on the estate tax return.

Issue #1: Quantity of Reporting – Consistent with Basis Consistency Rules?

The original intent of the basis consistency rules is set forth in the General Explanations of the Administration's Fiscal Year 2015 Revenue Proposals, as follows:

> *Taxpayers should be required to take consistent positions in dealing with the Internal Revenue Service. The basis of property acquired from a decedent generally is the fair market value of the property on the decedent's date of death. Consistency requires that the same value be used by the recipient (unless that value is in excess of the accurate value). In the case of property transferred on death or by gift[8] during life, often the executor of the estate or the donor, respectively, will be in the best position to ensure that the recipient receives the information that will be necessary to accurately determine the recipient's basis in the transferred property.*

Based on this intent, the Administration proposed the following:

> *The proposal would impose both a consistency and a reporting requirement. The basis of property received by reason of death under section 1014 must equal the value of that property for estate tax purposes . . . The proposal would require that the basis of the property in the hands of the recipient be no greater than the value of that property as determined for estate or gift tax purposes (subject to subsequent adjustments).*
>
> *A reporting requirement would be imposed on the executor of the decedent's estate ... to provide the necessary valuation and basis information to both the recipient and the Internal Revenue Service.*
>
> *A grant of regulatory authority would be included to provide details about the implementation and administration of these requirements, including rules for situations in which no estate tax return is required to be filed ... for situations in which the surviving joint tenant or other recipient may have better information than the executor, and for the timing of the required reporting in the*

[8]Note: the Act did not require a duty of consistency for transfers made by gift.

> *event of adjustments to the reported value subsequent to the filing of an estate . . . tax return.* [emphasis added]

The legislative history makes it clear that the reporting requirements under IRC § 6035 were enacted solely to enforce the basis consistency rules imposed under IRC § 1014(f). Treasury has exercised its regulatory authority to exempt certain property from the basis consistency rules (*see* Prop. Reg. § 1.1014-10(b)(2), exempting marital and charitable deduction property and certain lower valued tangible personal property); similarly, Treasury has exercised its regulatory authority to expand the statutory exemption to also exempt certain other property from the reporting requirements: cash, items of income in respect of a decedent, certain lower-valued tangible personal property and items that are sold in an income recognition transaction (*see* Prop. Reg. § 1.6035-1(b)(1)(i) – (iv)). We believe that the reporting exceptions should be further expanded to include all property that is not subject to the basis consistency requirement, specifically property qualifying for the marital and charitable deduction. Section 1014(f) and Prop. Reg. § 1.1014-10(b)(2) are clear that marital and charitable deduction assets are not subject to the basis consistency rules.

<u>Prop. Reg. § 1.6035-1(b)(1)(i) – (iv) – In General</u>

<u>Issue #1:</u> Other Suggested Exceptions

We respectfully request that Treasury include additional items on the list of items exempted from the reporting requirements. For example, we believe life insurance proceeds should be treated like cash and specifically exempted from basis reporting requirements. A loan that is forgiven under a decedent's testamentary instruments also should be exempted. Only loans held by the decedent that are actually distributed should be reportable.

<u>Issue #2:</u> Dealing with Liabilities for Assets Reported on a Net Value

Prop. Reg. § 1.1014-10(a)(2) provides that whether property subject to recourse or non-recourse debt is reported at gross value or net value does not affect the basis of the property. Example 1 of Prop. Reg. § 1.1014-10(e) illustrates a situation with assets subject to debt and helps to clarify the rule set forth in Prop. Reg. § 1.1014-10(a)(2). However, the example does not address how property subject to debt should be reported on Form 8971 and Schedule A thereto, especially in the situation where debt is reported on the Form 706 as a net value (as provided in Treas. Reg. § 20.2053-7). We respectfully suggest that Treasury provide guidance, and we recommend that the gross value (that is, fair market value calculated as if the debt were zero) be used for reporting required by IRC § 6035. We also respectfully request that Treasury provide an example.

<u>Issue #3:</u> Reporting Requirements Where All Assets are Excluded from Schedule A

We respectfully request clarification as to whether there is a Schedule A filing requirement when all of the assets that pass to the beneficiary are excluded for reporting purposes under 1.6035-1(b)(1). We posit the following example: Assume a decedent leaves an estate consisting only of cash, and after payment of all expenses, taxes, etc., the remaining cash of

$10 million is to be distributed to a non-spouse, non-charitable beneficiary. In this case a Form 706 is required. Prop. Reg. § 1.6035-1(a)(1) requires that all estates filing a Form 706 also file a Form 8971 and Schedule A. Interestingly, Prop. Reg. § 1.6035-1(b)(1)(i) excepts cash from the filing requirements. Thus, even though the executor has to file a Form 8971 and Schedule A, there are no assets to be reported on the form and schedule. In those situations where no assets are required to be reported on either Form 8971 or Schedule A, we suggest that filing should not be required.

Prop. Reg. § 1.6035-1(b)(1)(ii)

Issue #1: Income in Respect of a Decedent (as defined under IRC § 691) ("IRD")

With respect to the exclusion of IRD under Prop. Reg. § 1.6035-1(b)(ii), we respectfully request clarification in cases when a portion of an asset is IRD and a portion is not. For instance, a part of a partnership interest may be deemed to be IRD. Does that mean that the executor excludes that part which is IRD but reports that portion that is not?

By further example, with inherited IRAs, where the participant paid tax on some of her contributions to the IRA, technically part of the IRA is IRD and part is not. How does one report (or not report) that asset?

Finally, should Roth IRAs (not converted within 5 years of death) be added to the list of exceptions to basis consistency reporting, even if they are not IRD, since later distributions also never will be subject to income tax?

Prop. Reg. § 1.6035-1(b)(1)(iii)

Issue #1: Definition of Excluded Tangible Personal Property under Prop. Reg. § 1.6035-1(b)(1)(iii)

Please see the discussion under Prop. Reg. § 1.1014-10(b)(1) regarding tangible personal property, as the same definitional issues are problematic under Prop. Reg. § 1.6035-1(b)(1)(iii).

Prop. Reg. § 1.6035-1(b)(1)(iv)

There are several issues to address with respect to Prop. Reg. § 1.6035-1(b)(1)(iv), which excludes certain property from the reporting requirements, as follows:

> *Property sold, exchanged or otherwise disposed (and therefore not distributed to the beneficiary) of by the estate in which capital gain or loss is recognized.*

<u>Issue #1:</u> No Gain/No Loss Property

It may be the case that a sale or exchange triggers neither gain nor loss (i.e., where the fair market value is equal to the income tax basis). Should those cases be exempted, too? This issue is also discussed in the review of Prop. Reg. § 1.1014-10(a)(1).

<u>Issue #2:</u> Capital Assets v. Other Assets

Prop. Reg. § 1.6035-1(b)(1)(iv) only exempts assets that are considered "capital assets." What if the estate had inventory; would it be excluded if sold? Or, what if the estate had property that is a hybrid-type asset (e.g., IRC § 1231 property), and if a loss is suffered, thereby triggering an ordinary loss, would that property still be included? And how should so-called "hot assets" under IRC § 751 be handled (property such as partnerships holding capital assets subject to recapture (i.e., many real estate partnerships))? We respectfully request clarification; to be consistent with Prop. Reg. § 1.1014-10, Treasury might consider eliminating the word "capital," thus, exempting reporting of any property that is sold in a transaction in which a gain or loss may be recognized.

<u>Issue #3:</u> Pecuniary Bequest Exempted?

Satisfaction of a pecuniary bequest with property in kind is treated as a sale or exchange of the property in which gain or loss is recognized. *Kenan v. Comm'r*, 114 F.2d 217 (1940). The parenthetical clause in Prop. Reg. § 1.6035-1(b)(1)(iv), "(and therefore not distributed to a beneficiary)," calls into question whether property distributed to a beneficiary in satisfaction of a pecuniary bequest will be excepted from the reporting requirement. Simply put, it appears that the insertion of the parenthetical did not take into consideration the impact of so-called *Kenan* gain. We respectfully request correction and suggest deleting the parenthetical.

We do not see the rationale of reporting to the beneficiary the pecuniary bequest he or she would have received, where the basis of such received property had a date of distribution fair market value basis (as a result of the deemed sale under *Kenan*). Prop. Reg. § 1.1014-10-(a)(2) suggests that post-death adjustments "may include, for example, gain recognized by the decedent's estate or trust upon distribution of the property. . . ." We respectfully request clarification that reporting is not required when property is distributed in kind to satisfy a pecuniary bequest.

<u>[Prop. Reg. § 1.6035-1(b)(2) Examples]</u>

We have no comments.

Prop. Reg. § 1.6035-1(c) Beneficiaries

Prop. Reg. § 1.6035-1(c)(1) In general

Prop. Reg. § 1.6035-1(c)(1) defines a beneficiary as any person who receives property that is reported on the estate tax return.

Issue #1: Except Surviving Spouses and Charitable Beneficiaries

We respectfully request, for purposes of defining beneficiaries, that surviving spouses (who receive property for which a marital deduction is taken on Form 706) and charities (which receive property for which a charitable deduction is taken on the Form 706), both of whom therefore are not subject to the basis consistency rules should not be considered beneficiaries for purposes of receiving a Schedule A.

Issue #2: Clarify Split Interest Reporting Rules

Prop. Reg. § 1.6035-1(c)(1) provides that the executor must furnish a statement to each beneficiary and

> *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 . . .*

Prop. Reg. § 1.6035-1 (c)(2) states that only the trustee of a trust, and not its beneficiaries, must receive a Schedule A when the beneficiary is a trust.

Prop. Reg. §§ 1.6035-1(c)(1) and -1(c)(2) are inconsistent. We respectfully request clarification that the references to the life tenant and to the presumptive remainderman[men] in Prop. Reg. § 1.6035-1(c)(1) include only those life tenants and presumptive remainderman[men] of a legal life estate owned outright by individual taxpayers, and not the current and remainder beneficiaries of a trust.

Issue #3: Clarification of Contingent Interests

Prop. Reg. § 1.6035-1(c)(1) further provides that the beneficiary "of a contingent interest is a beneficiary, unless the contingency has occurred prior to the filing of Form 8971." We suggest that the final phrase quoted immediately above be clarified to say, "unless the contingency that negates the interest has occurred prior to filing Form 8971." In the alternative, the clause should read, "of a contingent interest is a beneficiary, unless the contingency has *not* occurred prior to the filing of Form 8971."

Are the provisions in Prop. Reg. § 1.6035-1(c)(1) intended to apply only to contingent interests other than contingent beneficial interests in trusts to which the executor distributes property? If not, the originally proposed language would appear to conflict with

Prop. Reg. § 1.6035-1(c)(2), which provides that the executor shall furnish Schedule A only to the trustee and not to the beneficiaries.

Finally, Prop. Reg. § 1.6035-1(c)(1) requires the executor to supplementally report a change of beneficiary if a contingency subsequently "negates" the inheritance of a beneficiary. The continuing duty for supplemental reporting imposed on an executor by this provision is impractical because an executor ceases to serve once the estate is closed. This continuing duty will be unduly burdensome on the executor and outside the scope of the duties imposed on the executor under local law. Therefore, we request that this burden of supplemental reporting be limited in time, as discussed more fully below in comments to Prop. Reg. § 1.6035-1(e).

Prop. Reg. § 1.6035-1(c)(2) Beneficiary not an individual

Prop. Reg. § 1.6035(c)(2) provides that if the beneficiary is a trust (or other estate), the executor must furnish Schedule A to the trustee (or other executor), and if the beneficiary is a business entity, the executor must furnish the Schedule A "to the entity." Such a trust, estate, or entity is subject to the continuing reporting requirements of Prop. Reg. § 1.6035(f).

Prop. Reg. § 1.6035-1(c)(3) Beneficiary not determined

Prop. Reg. § 1.6035-1(c)(3) describes the type of property that should be included on Schedule A, if, by the due date of the Form 8971, the executor has not determined the particular property that will be used to satisfy a beneficiary's interest. The proposed regulation requires a report to the beneficiary of all property that the executor *could* use to satisfy the beneficiary's interest and authorizes, but does not require, the executor to file a supplemental Statement once the final determination by the executor has been made.

Issue #1: Prop. Reg. § 1.6035-1(c)(3) May Cause a State Law Breach of Fiduciary Duty

We note that the requirements of this provision could impose obligations on the executor in conflict with the executor's fiduciary duties. Schedule A is required to be sent to the beneficiary within a short period of time after the return is due or the return was filed (i.e., according to Prop. Reg. § 1.6035-1(d) within the earlier of 30 days after the due date of the estate tax return or after the date on which the return actually is filed). As a practical matter, this is a date by which most executors, especially those of larger estates such as those subject to these rules, have not yet determined which assets will satisfy the interests of beneficiaries. We believe that, in an effort to require reporting within 30 days after the estate tax was due (or filed, if earlier) and acknowledging that executors would not know "who got what," Treasury intended this provision to be helpful. However, this provision effectively imposes a duty on the executor to provide a list of most of the estate assets to beneficiaries who ultimately may receive only a fraction of the assets on that list. In addition to likely being confusing to a beneficiary who may receive the Schedule A (i.e., believing he or she will get all of the listed assets), we are concerned that this provision may give information to beneficiaries that they would not otherwise be entitled to receive. Particularly in the case of contested estates, the requirement of this provision forces the executor to disclose otherwise confidential information to beneficiaries and may encourage executors to liquidate estate assets if only to avoid this disclosure.

Based on the foregoing, we respectfully request that Treasury consider an alternative reporting procedure for executors who have not yet determined which estate assets will be used to satisfy a beneficiary's interest as of the due date for filing Form 8971.

We discuss this suggestion below, when we discuss the due date under Prop. Reg. § 1.6035-1(d)(1).

<u>Issue #2:</u> Clarification of Prop. Reg. § 1.6035-1(c)(3) and Prop. Reg. § 1.6035-1(e)(3)(ii)(Example 2)

Prop. Reg. § 1.6035-1(c)(3) provides that in filing Form 8971, "all of the property that the executor could use to satisfy that beneficiary's interest" must be listed. However, Prop. Reg. § 1.6035-1(e)(3)(ii)(Example 2) suggests that only reportable property must be listed. And the language of the proposed regulation is unclear. We respectfully request further guidance on this point.

<u>Prop. Reg. § 1.6035-1(c)(4) Beneficiary not located</u>

<u>Issue #1:</u> What is Reasonable Due Diligence?

Prop. Reg. § 1.6035-1(c)(4) requires an executor to use "reasonable due diligence" to identify and locate all beneficiaries. We respectfully request clarification on what efforts will satisfy the "reasonable due diligence" requirement and recommend that any efforts that satisfy the requirements set forth under local law to identify unknown distributees will be sufficient for the purposes of this provision as well.

<u>Prop. Reg. § 1.6035-1(d) Due dates</u>

<u>Prop. Reg. § 1.6035-1(d)(1) In general</u>

<u>Issue #1:</u> Filing Requirement for Form 8971 and Schedule A is Impractical

IRC §§ 6035(a)(3)(A)(i) and (ii) provide the statutory period of time when a Schedule A should be filed, being the earlier of (i) the date 30 days after the date that a Form 706 was required to be filed, or (ii) the date that the Form 706 was actually filed (we refer to earlier of these two 30-day periods together as the "original 30-day period"). Consistent with IRC § 6035(a)(3)(A), Prop. Reg. §§ 1.6035-1(d)(1)(i) and (ii) require that Schedule A must be provided to the beneficiary within the original 30-day period, as well. As a practical matter, the original 30-day period is a date by which most executors will not have determined which assets will satisfy the interests of many (if not most) beneficiaries. Thus, we respectfully submit that the original 30-day period filing requirement for Schedule A is much too short a time period.

Understanding that the statutory requirement set forth in IRC § 6035(a)(3)(A) binds Treasury to imposing the same time period for filing a Schedule A, we respectfully request that Treasury consider giving the executor the option of either (a) complying with the original 30-day period rule and providing the information requested, or (b) allowing an alternative rule where the executor could in good faith report the estimated dollar amount or value that each beneficiary is anticipated to receive based on the Form 706 values. After actual distributions to the beneficiary of the beneficiary's share, if the executor elected the alternative method, the executor could be required to file a supplemental Schedule A within 30 days of the distribution to the beneficiary detailing the information that would otherwise have been required had the executor filed the Schedule A within original 30-day period. This approach would allow for the practicalities of estate administration by: (a) giving the IRS and the beneficiary the reportable information; (b) providing relevant information on a timely basis; (c) allowing the executor time to determine what assets pass to the beneficiary and then providing only the basis information that the beneficiary needs for that beneficiary's purposes (instead of possibly receiving an extensive list of all assets in the estate and having to determine the basis by searching for the beneficiary's asset in a lengthy list); and (d) promoting administrative efficiency, while not compromising the information that is to be sent to the IRS and the beneficiary.

<u>Prop. Reg. § 1.6035-1(d)(2) Transition rule</u>

<u>Issue #1:</u> Whether a Supplemental Return Would Trigger Filing Requirements

We have discussed the issue of whether supplemental reporting to Form 706 would trigger the application of the basis consistency rules under Prop. Reg. § 1.1014-10(f). We respectfully pose the same question here in the context of the filing requirements under Prop. Reg. § 1.6035-1. Stated otherwise, would supplemental reporting of information after July 31, 2015, with respect to a Form 706 filed before July 31, 2015, create a duty to file Form 8971 and Schedule A? We do not believe that merely providing supplemental information would, because supplementing information for an estate tax return is not the filing of a return. In addition, filing a supplemental return does not extend the period of limitation, and, thus, by analogy should not cause an estate to be subject to new filing requirements after a particular date (i.e., July 31, 2015). For a discussion of supplemental reporting, *see* Pratt & Karibjanian, *Filing a Supplemental Estate Tax Return After Probate Litigation*, 36 Est. Plan. 17 (Sept. 2009).

<u>Prop. Reg. § 1.6035-1(e) Duty to supplement</u>

We have no comment.

<u>[Prop. Reg. § 1.6035-1(e)(1) In general]</u>

We have no comment.

[Prop. Reg. § 1.6035-1(e)(2) Adjustments requiring supplement]

We have no comment.

[Prop. Reg. § 1.6035-1(e)(3) Adjustments not requiring supplement]

We have no comment.

[Prop. Reg. § 1.6035-1(e)(3)(i) In general]

We have no comment.

[Prop. Reg. § 1.6035-1(e)(3)(ii) Example]

We have no comment.

[Prop. Reg. § 1.6035-1(e)(3)(ii) Example 1]

We have no comment.

Prop. Reg. § 1.6035-1(e)(3)(ii) Example

See comment above in Issue #2 for Prop. Reg. § 1.6035-1(c)(3).

Prop. Reg. § 1.6035-1(e)(4) Due date of supplemental reporting

Prop. Reg. § 1.6035-1(e)(4)(i) In general

We have no comment.

[Prop. Reg. § 1.6035-1(e)(4)(ii) Probate property or property from decedent's revocable trust]

We have no comment.

Prop. Reg. § 1.6035-1(f) Subsequent transfers

We respectfully believe that the scope and extent of successive reporting obligations of "subsequent transfers" to future owners of property, whom we have termed "derivative asset owners" in these Comments, requires modification. Further, as discussed below, without the addition of reasonable limitations, the proposed regulation appears to impose a potentially never-ending reporting requirement on any transferor of an asset "that previously was reported or is required to be reported on [Form 8971]." Reporting obligations of unlimited duration over multiple transfers, which could last for multiple generations, seem unfairly burdensome in most circumstances. We respectfully request that the Treasury consider imposing reasonable limitations on ongoing reporting for derivative assets owners under Prop. Reg. § 1.6035-1(f). We propose such limitations for your consideration, below.

We respectfully note that there is no statutory basis for this reporting requirement. IRC § 6035 only imposes reporting requirements on executors and not subsequent transferors. Accordingly, we respectfully request that provisions that impose reporting requirements on subsequent transferors be removed.

<u>Proposal: Time Limits</u>

If a subsequent transferor rule is adopted, we respectfully suggest that Treasury consider imposing a limit on the time period in which subsequent transfers are required to be reported.

The need to limit reporting seems particularly appropriate for the nearly half of all estates (approximately 5,000 - 6,000 estates per year) that do not pay estate tax and are exempt from the duty to report basis consistently under IRC § 1014(f)(2). For these estates, their executors will be reporting without purpose, and exempting or limiting such assets from ongoing reporting requirements seems appropriate.

<u>Open Issues:</u>

In addition to the two foregoing, overarching suggested improvements, we offer the following comments concerning suggested technical revisions:

<u>Issue #1:</u> Unknowing Transferees

Prop. Reg. § 1.6035-1(f) states, in part, as follows:

> *(f)* Subsequent transfers*. If all or any portion of property that previously was reported or is required to be reported on an Information Return (and thus on the recipient's Statement or supplemental Statement) is distributed or transferred (by gift or otherwise) by the recipient in a transaction in which a related transferee determines its basis, in whole or in part, by reference to the recipient/transferor's basis, the recipient/transferor must, no later than 30 days after the date of the distribution or other transfer, file with the IRS a supplemental Statement and furnish a copy of the same supplemental Statement to the transferee.*

Read literally, this section could apply to many derivative asset owners who may not know that they have this duty to report. The following example illustrates our concern.

Event 1 - Decedent, G1, dies with a taxable estate leaving the balance of his estate (after paying debts, expense, and taxes) to his daughter, G2.

Event 2 – Months later, G1's executor, E, timely files a properly prepared and completed Form 706.

Event 3 – Within the period for filing, E files Form 8971 and Schedule A with the IRS and sends Schedule A to G2.

Event 4 – Months after the Form 706 is completed, G2 receives the following assets from G1's executor, E, as her share of G1's estate:

> (a) a portfolio of marketable securities (assume 100+ securities) worth $5 million;
> (b) a portfolio of real estate (10 parcels of land) worth $10 million;
> (c) closely held business interests (assume a minority ownership in five businesses) worth $5 million; and
> (d) cash of $2 million.

Events 5 and 6 – Over multiple months, G2 funds her revocable trust (G2RT) with assets received from E. Assume that there were 10 transfers.

Event 7 - Years later, G2, G2RT and her daughter, G3, form an LLC. G2 contributes various portions of what she received from G1 into several LLCs, along with G2's assets received from savings from her work ("G2's work assets"). G3 contributes assets that she accumulated from working ("G3's work assets"). Assume that the contribution to the LLC was tax free, thus, the basis of the LLC interests owned by G2 and G3 would be determined in whole or in part on the basis of assets that G1 gave to G2 (at G1's death).

Event 8 – G3 funds her revocable trust (G3RT) with assets received from G2 (originally received from G1).

Event 9 and 10 – Periodically, G2RT transfers assets from G2RT to G2, who then sells those assets to raise cash.

Event 11 - G2 makes two gifts: Gift 1 – G2 gives the following assets outright to G3: (a) some of her LLC interests, (b) assets acquired from G1, and (c) G2's work assets. Gift 2 – G2 gives similar assets in an irrevocable multi-generational grantor trust, T, of which G3 and her descendants are beneficiaries.

Events 11 and 12 – LLC makes periodic (annual) distributions of cash and assets in kind to the owners (i.e., G2, G3 and T). G2 and G3 fund their respective revocable trusts (G2RT and G3RT) with, in part, these distributions.

Event 13 – G2 enters into a Limited Partnership (LP) with her son, G4, and contributes some assets she received from G2 (which were received from G1) and LLC units that she received from G2.

Event 14 – LP distributes property in kind to G3 and G4.

Event 15 – G3 creates a revocable trust, G3RT, and funds G3RT with distributions from LP.

This is not an unusual fact pattern. The following is a list of transfers captured under Prop. Reg. § 1.6035-1(f) with respect to assets, the basis of which is determined in whole or in part to G1's basis at his date of death:

- Every transfer from G2 to her revocable trust, G2RT. In our scenario, there would be 10 transfers over the period of settlement of G1's estate;
- Every transfer from G2 to the LLC;
- Every transfer from LLC to G2, G3 and T;
- Every transfer from G2 back to G2RT;
- Every transfer from G3 to her revocable trust, G3RT;
- Every transfer from G3 to G3RT; and
- Every transfer from G3 to G4.

Interesting to note: if just one of G1's assets is contributed to an LLC and the asset makes up even .00001% of the value of the assets of the LLC, the basis of the LLC in the hands of G2, G3, G4, etc., is determined in whole or in part by G1's asset. And if G1's assets are transferred to the LLC, and all of those assets are sold and gain/loss if fully recognized, so long as that LLC continues, the basis of the LLC interest will always be determined "in whole or in part" with regard to G1's assets.

Further, if the LLC keeps some of G1's assets and at some later point in time terminates, and assets are distributed even though G1's assets are distributed and take a basis totally different from G1's basis (because of the liquidation rules under partnership law), the basis of all of the assets from the LLC, and not just the original assets that were G1's at his death, will be determined "in whole or in part" with regard to G1's date of death value.

Although this example is somewhat complex, it demonstrates the unfortunate result of the multiple reporting that would occur under Prop. Reg. § 1.6035-1(f). We clearly understand Treasury's desire to track basis and ensure that basis consistency is maintained. However, this reporting structure would be unduly onerous, very expensive and time consuming, and may be missed by many derivative asset owners, subjecting them to filing penalties, interest, and additional costs (including, but not limited to, costs of engaging a professional to advise them).

We respectfully request that Treasury reconsider the efficacy of this provision and the tremendous burden and potential results that it would has create. And we request that Treasury consider whether this provision should be significantly modified or even removed.

<u>Issue #2:</u> Related Transferees – Members of the Family – A gap

The penultimate sentence in Prop. Reg. § 1.6035-1(f) states:

> *For purposes of this provision, a related transferee means any member of the transferor's family as defined in section 2704(c)(2), any controlled entity (a corporation or any other entity in which the transferor and members of the transferor's family (as defined in section 2704(c)(2)), whether directly or indirectly, have control within the meaning of section 2701(b)(2)(A) or (B)), and any trust of which the transferor is a deemed owner for income tax purposes.*

The reference in Prop. Reg. § 1.6035-1(f) to IRC § 2704(c)(2) on its face appears to be incomplete, particularly in the scope of its application to trusts (i.e., the most common beneficiary of estates that must file estate tax returns (i.e., estates to which the reporting requirements apply)).

IRC § 2704(c)(2) has the following definition for members of the family:

> *(c)(2) Member of the family. The term "member of the family" means, with respect to any individual—*
>
> > *(A) such individual's spouse,*
> >
> > *(B) any ancestor or lineal descendant of such individual or such individual's spouse,*
> >
> > *(C) any brother or sister of the individual, and*
> >
> > *(D) any spouse of any individual described in subparagraph (B) or (C).*

IRC § 2704(c)(2) defines related members of an *individual's* family and does not on its face apply to trusts; nor would it apply to partnerships or other entities. Therefore, a trust distribution to a beneficiary would not seem to be a transfer to a "related transferee." Historically, for good reasons, courts have very strictly construed attribution rules such as those found in § 2704, among other statutes. We respectfully request that Treasury review this provision and determine how to clarify the issues presented.

<u>Issue #3:</u> Related Transferees – Distributions to a Trust

Prop. Reg. § 1.6035-1(c)(1) provides that if a decedent's property is distributed to an individual beneficiary, the executor must furnish the individual beneficiary with a Schedule A. Further, Prop. Reg. § 1.6035-1(c)(2) requires that if the decedent's property is distributed to a trust, the executor need only notify the trustee of the trust. Prop. Reg. § 1.6035-1(f) includes a trust as a related transferee <u>only if</u> the person making the transfer to the trust is the deemed owner of the recipient trust for income tax purposes.

<u>Issue #4:</u> Related Transferees – Distributions from a Trust

Based on the foregoing, it appears that an outright gift from an estate to a family member would be reportable and a transfer from an estate to a trust for the benefit of the family member would also be reportable, but a subsequent transfer from a non-grantor trust to family members would not be reportable (even if the transfer was made immediately after the trust received the property). We respectfully submit, as a matter of tax policy, that this result is inexplicably inconsistent.

Example

The following example, which is probably the most common distribution scenario, is illustrated here:

- Decedent dies and the asset becomes part of decedent's probate estate.

- Decedent's will directs that the residue of the probate estate is to pour over to Decedent's revocable trust. The trustee of the revocable trust is a beneficiary as defined in IRC § 6035(a) and Prop. Reg. § 1.6035-1(c).

- The revocable trust provides that upon death, the assets (after paying debts, expenses and taxes) in the revocable trust (whether there at death or acquired after death) are to fund: (a) a marital trust—usually a QTIP Trust; and (b) a credit shelter trust. Neither of these transferee trusts are grantor trusts and thus are not "related transferees" under Prop. Reg. § 1.6035-1(f) (penultimate sentence); neither transferee trust is a member of the transferring revocable trust's family under IRC § 2704(c)(2). Accordingly, the trustee of the revocable trust, as a subsequent transferor, does not appear to be "related" to the marital and credit shelter trusts or have a reporting obligation to them.

Thus, after funding the marital and credit shelter trusts,[9] even if the trusts subsequently distribute assets, there is no related transferee requirement to notify the beneficiaries, even if the trustees of those trusts were to distribute the trust outright to the beneficiaries. We compare the treatment in this scenario and the lengthy example we posed above, where the reporting could go on for generations.

Continuing with the previous example, assume the revocable trust made an IRC § 645 election. If the (presumably qualified) revocable trust has made an election under IRC § 645, then it appears that the operation of these rules is much less clear and should be clarified by

[9] The transfer of the assets from the probate asset to the revocable trust, which is sometimes called an "administration trust" during the administration process, is a transfer to a beneficiary. That is, the administration trust is the recipient of property. Therefore, the executor would only have to provide the Schedule A to the trustee of the administration trust and not to the beneficiaries of such trust. The trustees of the revocable trust would not report distributions to the marital or the credit shelter trust, because they are not "related transferees."

the final regulations. Although the IRC § 645 election results in the revocable trust being treated as a part of the estate for income tax purposes during the election period, the revocable trust is not ignored for income tax purposes to the same extent as a grantor trust. By example, separate share accounting is required for the qualified revocable trust under IRC § 663(c), a separate EIN may be required for the qualified revocable trust, and for state law purposes, the duties of the executor and trustee (who may be different persons) are distinct. We respectfully request that Treasury clarify which fiduciary is responsible for filing the statements.

Furthermore, it is unclear whether partial or full funding should affect reporting requirements. Overall, we respectfully suggest that a better approach would be for only the executor to file Form 8971 and any Schedule A, as placing the obligation on the executor is most consistent with the statute. Only if no executor is appointed (i.e., because a revocable trust is fully funded and no other non-exempt non-probate assets must be reported) should the trustee file statements in the executor's stead.

Notwithstanding our comments above, on balance, we submit that this regulation has far greater reach than intended by Congress, and we respectfully request that Treasury consider removing the provision or substantially modifying it.

Issue #5: Related Transferees – Transfers to "Grantor Trusts"

In defining related transferees, the last clause of the penultimate sentence in Prop. Reg. § 1.6035-1(f) states, ". . . and any trust of which the transferor is a deemed owner for income tax purposes."We note that under Revenue Ruling 85-13, 1985-1, C.B. 184, 1985-7 I.R.B. 28, if the grantor of a trust is deemed to be the owner, then the income tax implications (including gains from the sales of assets) are to be reported by the grantor. In this case, it appears that the transferor will be required to send the trustee a Schedule A informing the trustee of the basis of an asset that the trustee would have no responsibility to report on if such asset was sold or otherwise disposed of. Because the transferor remains taxable on trust assets, the trustee is not the person who needs this information. We respectfully submit not only for this reason but also for others discussed below that Treasury should consider removing this provision

Issue #6: Related Transferees – Partial Grantor Trusts

The grantor trust rules (IRC §§ 671 – 678) provide that a trust may be a grantor trust as to income, principal or both. They also contemplate that a trust may be a grantor trust as to part of the trust (e.g., 50%, 68%, or some other portion). The language in Prop. Reg. § 1.6035-1(f) does not contemplate partial ownership. For example, if the trust is a grantor trust only as to a portion of its assets, Schedule A does not contemplate how the executor would report the partial grantor-trust status on Schedule A. Likewise, if the trust is a grantor trust only as to the income, and not the corpus, Schedule A does not contemplate how the executor would reflect the split on Schedule A. (Further, if a trust is a grantor trust as to income, typically the sale of an asset would generally trigger capital gain but is not an item of income for which the trust would be responsible; rather it would be the grantor's responsibility). Accordingly, in this instance, it seems that reporting the asset on Schedule A would not be useful.We respectfully request that Treasury consider how to address partial grantor trusts.

<u>Issue #7:</u> Related Transferees – Revocable Trusts are Grantor Trusts – and Therefore "Related Transferees"

Because revocable trusts are trusts "of which the transferor is a deemed owner for income tax purposes," a surviving spouse's, or other beneficiary's, straightforward and common action to fund a revocable trust would require reporting to his or her own revocable trust (usually to himself or herself as trustee) to the IRS, and perhaps to the executor if estate values are not final. We respectfully submit that unnecessary reporting creates a burden that the final regulations should exempt. Specifically, the regulation could provide that trusts that are grantor trusts because of their revocability under IRC § 676 are not subject to a reporting requirement.

<u>Issue #8:</u> Related Transferees – Change in Grantor Trust/Complex Trust Status

While we recognize that under certain circumstances a change in the taxation of an irrevocable trust from a grantor trust to a complex trust, or vice versa, might be *deemed* to be a transfer for income tax purposes, we suggest that the final regulations clarify that a mere change in the grantor trust status of an irrevocable trust without any retitling of trust assets should not be treated as a retransfer of prior estate assets, requiring the grantor or the trustee to reflect on Schedule A. Regardless, if Treasury chooses to require reporting in this circumstance, it would be helpful if the final regulations clarify who (grantor, executor, or trustee) must report to whom (trustee or beneficiaries) and whether the timing of the change in status during life or at death affects the reporting requirements.

<u>Issue #9:</u> Related Transferees – Powers of Appointment

Reporting duties related to powers of appointment in trusts (or other instruments) are unclear in the proposed regulation. If a reportable prior estate asset later is appointed by a power holder out of a trust to a "related transferee" through the exercise of a limited power of appointment, we respectfully request clarification whether the trustee or the power holder must provide Schedule A to the appointee and the IRS. Additionally, further clarification is required in where the power of appointment is a general or limited. Finally, we also respectfully request further clarification concerning whether the measuring relationship is between the appointee and: the trustee, or the power holder.

<u>Prop. Reg. § 1.6035-1(g) Definitions.</u>

<u>Prop. Reg. § 1.6035-1(g)(1) Executor</u>

<u>Issue #1:</u> Clarifying the term "executor"

In defining the term "executor," Prop. Reg. § 1.6035-1(g)(1) provides, "Executor has the same meaning as in section 2203 and includes any other person required under section 6018(b) to file a return."

We respectfully request clarification in light of the language under IRC § 2203, which states,

> *The term "executor" wherever it is used in this title in connection with the estate tax imposed by this chapter means 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.*

And Treas. Reg. § 20.2203-1, states,

> *The term executor means the executor or administrator of the decedent's estate. However, if there is no executor or administrator appointed, qualified and acting within the United States, the term means any person in actual or constructive possession of any property of the decedent. The term "person in actual or constructive possession of any property of the decedent" includes, among others, the decedent's agents and representatives; safe-deposit companies, warehouse companies, and other custodians of property in this country; brokers holding, as collateral, securities belonging to the decedent; and debtors of the decedent in this country.*

Under IRC § 2203, there can be only one executor unless "there is no executor or administrator appointed, qualified, and acting within the United States," in which case any person in actual or constructive possession of any property of the decedent is an "executor." On the other hand, under IRC § 6018(b), there could be one or more persons in addition to the appointed executor who are required to file a federal estate tax return. Thus, it is certainly possible that under the definition of "executor" contained in the proposed regulations, there could be multiple executors acting simultaneously with respect to a single estate. We respectfully request that Treasury modify this provision so that duplicative reporting is avoided. Perhaps Treasury could look to the portability regulations as a guide and use an approach where certain executors have the duty to report, while others do not.

Issue #2: Multiple Executors

Further, there may be situations where multiple executors may have been appointed, for instance, if there was incapacity, a conflict of interest or litigation. We request clarification as to whether, and to what extent, an appointed executor is relieved of filing and reporting requirements under IRC § 6035 (and the regulations to be finalized thereunder) when a second (or third or fourth) executor is acting with respect to the same gross estate.

Issue #3: Persons with Better Information Than Executors

IRC § 6035(b)(2) requires the Secretary to prescribe regulations as necessary to carry out section 6035, including regulations relating to "situations in which the surviving joint tenant or other recipient may have better information than the executor regarding the basis or fair market value of the property." Persons with better information than the executor could include: (1) surviving joint tenants, and (2) trustees of trusts includible in a decedent's gross estate under IRC §§ 2044, 2036, or 2038. Although such persons may have better information than the executor, they may or may not be required to file a return under IRC § 6018(b), and thus may or may not be defined as executors under Prop. Reg. §§ 1.1014-10(d) and 1.6035-1(g)(1). This determination turns on whether the executor (as defined in IRC § 2203) is "unable to make a complete return as to any part of the gross estate." *See* IRC § 6018(b). For example, if the executor is not the trustee of a trust included in a decedent's gross estate under IRC § 2044 and the executor is unable to make a complete return as to the assets of that trust because of lack of cooperation of the trustee, that trustee will be required to file a return under IRC § 6018(b). That trustee will also be defined as an executor under Prop. Reg. §§ 1.1014-10(d) and 1.6035-1(g)(1). We respectfully ask for confirmation that the appointed executor is not required to file a Form 8971 or provide any statements to either the trustee or the trust's beneficiaries in such a situation.

The only regulatory guidance under IRC § 6035(b)(2) includes in the definition of executor, in Prop. Reg. §§ 1.1014-10(d) and 1.6035-1(g)(1), "any other person required under IRC § 6018(b) to file a return." Who is to file if, in the above example, the appointed executor is "able to make a complete return" for purposes of IRC § 6018(b) so that the trustee is not required to file a return, but the trustee nevertheless has better information than the executor regarding the basis and fair market value of the property in the trust? Is the trustee of such a trust considered a "recipient/transferor" under Prop. Reg. § 1.6035-1(f), to whom the subsequent transfer reporting rules apply, even though that trustee has not received property from the executor? Given that the executor is not transferring property to the trustee, but the trustee is not an executor as defined in the proposed regulations, is the executor required to furnish Statements to the beneficiaries of that trust? We respectfully request clarification.

Prop. Reg. § 1.6035-1(g)(2) Information Return

We have no comments.

Prop. Reg. § 1.6035-1(g)(3) Statement

We have no comments.

Prop. Reg. § 1.6035-1 (h) Penalties

We have no comments.

Prop. Reg. § 1.6035-1 (h)(1) Failure to timely file complete and correct Information Return

Prop. Reg. § 1.6035-1(h)(1) sets forth the penalty for failure of an executor to timely file complete and correct Forms 8971 or failure to "include all of the required information" on such form. The beneficiary's taxpayer identification number ("TIN") must be provided on the Form 8971, but not all beneficiaries will previously have been issued a TIN prior to the due date of the Form 8971. Further, not all beneficiaries may be eligible to apply for TINs prior that date. For example, nonresident alien beneficiaries who have never needed to claim tax treaty benefits or to file a U.S. tax return may never have applied for a TIN. Trusts that have yet to been funded also may not yet have applied for a TIN. The executor will have no control over the TIN applications of the beneficiaries. We respectfully request confirmation, in the first instance, that Form 8971 will be sufficient reason for applying for a TIN for nonresident alien beneficiaries. Further, we respectfully request relief for an executor who has such a beneficiary who either has not or will not request a TIN for these purposes. To the extent the executor has notified a beneficiary of the need to request a TIN within a reasonable period of time and the beneficiary does not have one by the due date of the Form 8971, we respectfully request clarification of how the executor should file the Form 8971 and confirmation that failure of the executor to include a TIN on the Form 8971 for that beneficiary will not cause the executor to be deemed to have filed an incomplete form.

Prop. Reg. § 1.6035-1 (h)(2) Failure to timely furnish correct Statements

We have no comments.

Prop. Reg. § 1.6035-1 (h)(i) Effective/applicability date

We have no comments.

Prop. Reg. § 1.6035-2 Transition relief

We have no comments.

Prop. Reg. § 1.6662-8 Inconsistent estate basis reporting

We have no comments.

<u>Prop. Reg. § 1.6662-8(a) In general</u>

We have no comments.

<u>Prop. Reg. § 1.6662-8 (b) Inconsistent estate basis</u>

For comments related to potential penalties for inconsistent estate basis reporting due to post-death adjustments to basis, please see the discussion under Prop. Reg. § 1.1014-10(a)(2) above.

Prop. Reg. § 1.1014-10(c)(2) provides that a taxpayer may not rely on the statement initially furnished under IRC § 6035(a) in the event of a subsequent adjustment to final value and specifically indicates that the taxpayer may have a deficiency and underpayment resulting from this difference. Prop. Reg. § 1.6662-8 imposes the negligence penalty on the underpayment of tax if the basis reported by the taxpayer is different from the final estate tax value. In some circumstances, it would be unreasonable to apply this rule.

For example, suppose an executor furnishes a Schedule A to a beneficiary 30 days after a decedent's estate tax return is filed. The recipient of that property relies on that Schedule A to report the basis of an asset sold by the recipient six months after the Schedule A is provided. Many years later, the executor settles an audit with the IRS resulting in the value of the asset distributed to the beneficiary less than what was originally reported to that beneficiary. In that case, the beneficiary should not be liable for penalties, particularly if the beneficiary takes prompt steps (within the limitations period) to amend his or her income tax return to report the correct basis of the property.

<u>Prop. Reg. § 1.6662-8(c) Applicable property]</u>

We have no comments.

<u>Prop. Reg. § 1.6662-8(d) Effective/applicability date]</u>

We have no comments.

III. <u>Miscellaneous Additional Comments</u>

A. Foreign Beneficiaries

Form 8971 requires the TIN of each beneficiary. The instructions state that writing "none" or "unknown" will result in the form being considered incomplete and possibly subject to penalties. A particular challenge, perhaps not considered, is when the estate beneficiaries are foreign persons. The foreign persons may not have obtained an ITIN (the TIN equivalent for a foreign person not eligible for a US social security number).

Obtaining an ITIN can often take several months. Consequently, executors will need to be proactive in requesting that foreign beneficiaries obtain an ITIN. When an executor supplies beneficiaries' TINS, including those of foreign person beneficiaries, the IRS may not have the authority to request the ITIN information of foreign person under existing regulations. Treas. Reg. § 301.6109-1(b)(2) and (c) provides the rules for when one can file a return with another person's identifying information, and this regulation provides limited circumstances where a foreign person must obtain an ITIN; these limited circumstances do not provide for basis reporting.

B. Indefinite Valuation Adjustments

In many instances, when an estate goes through audit and there are adjustments to value, there is generally a global settlement about a number of issues. Often, the Service and the estate come to a number that makes sense, not specifically adjusting each and every asset to determine the value. Rather, the executor and the IRS often agree on an amount on a schedule, which then translates to an agreed amount of additional tax (or refund). IRC § 6035(a)(3)(B) contemplates that there could be adjustments but neither the statute nor the proposed regulations details what happens in these situations. We respectfully request that Treasury provide such guidance. The basis consistency regulations and their requirements should not cause a fundamental change to the efficient and professional negotiation process that taxpayers engage in with the Service by requiring "line item" negotiations on the fair market value of each and every asset. Such an approach would spell the end of the efficiency and effectiveness of global settlement agreements.[10]

C. No Recourse for Beneficiaries

When an executor negotiates a settlement with the Service, there may be adverse consequences to one beneficiary versus another. And the only way for a beneficiary to contest the negotiated estate tax value would be to seek state law remedies. The proposed regulations contain no mechanism for a beneficiary to challenge the executor's determination of value set forth on the statement required to be provided to the beneficiary pursuant to IRC § 6035 or the final value of property received by the beneficiary, even though the final value of such property may be the result of negotiations between the executor and the Service to which the beneficiary was not a party.

The lack of a mechanism for a beneficiary to challenge the value of property subject to the basis consistency requirements could, in many situations, result in adverse and inequitable tax consequences to the beneficiary. We respectfully request that Treasury consider adding a mechanism for a beneficiary to challenge the value reported on the Schedule A, to contest the final value of property for purposes of basis consistency, or at least to notify the Service

[10]Furthermore, we reference our comments under Prop. Reg. § 1.6035-1(b)(1) and -1(f), above, and we observe that *any* audit of an entity, such as an LLC, which contains prior estate assets subject to basis consistency reporting often would appear to create a "line item" allocation of adjustments within the entity, even where estate fair market values and basis consistency requirements are not the primary purpose of the audit.

that the beneficiary disagrees with the final value of property received and intends to pursue a remedy in state court.

IV. CONCLUSION

We appreciate your consideration of our comments in response to REG-127923-15 and would be pleased to answer any questions.