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Elaine Gagliardi on Consistent Basis Reporting: Are Proposed Regulations Consistent with Congress's Basis for Enactment?

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By Elaine Gagliardi[1]

§ 1.01 Introduction

The first consistent basis returns became due June 30, 2016,[2] almost one year after enactment of the filing requirement by Congress. The basis consistency rules only apply to persons filing and property reported on estate tax returns filed after July 31, 2015.[3] As of the initial due date for filing Form 8971, its accompanying instructions conflicted with recently proposed regulations, leaving executors and their advisors to grapple with the ambiguities and differences.[4] Comments on the proposed regulations generally call for revisions to make compliance less costly and, more importantly, reflective of the purpose underlying enactment of the basis consistency rule which requires the same value to be used by a recipient of decedent's property in determining basis as was reported by the executor for estate tax purposes.[5]

The consistent basis reporting requirement provides the mechanism for notifying the Internal Revenue Service and those beneficiaries subject to the basis consistency rule of the maximum basis that may be claimed by the beneficiaries for income tax purposes.[6] The proposed reporting regulations, however, extend the duty to report beyond that contemplated by the enacting legislation. Although, the statutory language triggering application of the basis consistency requirement itself differs from that prompting application of the reporting rule, a fair reading of both statutes limits application to beneficiaries of those decedent's estates required to file an estate tax return and, further, does not suggest that it applies to any assets not reported on a return and for which a final value has not been determined. Despite the limiting provisions of the statutory language, the proposed regulations stretch the reporting requirement to apply in some cases to

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[2] IRS Notice 2016-27, 2016-15 I.R.B. 576; Instructions to Form 8971.

[3] IRC § 6035; Pub L No 114-41, Title II § 2004(d), 129 Stat 454 (2015) (effective for returns filed after date of enactment which was July 31, 2015); IRS Notice 2015-57, 2015-36 IRB 294.

[4] REG–127923–15, 2016-12 IRB 473.

[5] *See, e.g.,* American College of Trust and Estate Counsel Comments on Proposed Rules on Consistent Basis Reporting Between Estate, Person Acquiring Property From Decedent submitted May 27, 2016; AICPA Comments on Proposed Rules on Consistent Basis Reporting Between Estate, Person Acquiring Property From Decedent submitted June 1, 2016.

[6] IRC § 1014(f); Pub L No 114-41, Title II § 2004(d), 129 Stat 454 (2015) (effective for returns filed after date of enactment which was July 31, 2015); Notice 2015-57, 2015-36 IRB 294.

donees of a beneficiary,[7] and, in draconian style, impose a zero basis on the beneficiary if the executor fails to discover and report an asset on the estate tax return.[8]

After discussing the purposes that underlie enactment of the basis consistency rules and reporting requirement as acknowledged by the Internal Revenue Service, this article sets forth the details of the proposed regulatory scheme. It analyzes the proposed regulations both from the point of view of whether there might exist a more time and cost efficient method of protecting the interests of the Internal Revenue Service, and whether the regulatory requirements fall within the authority granted by Congress to issue regulations. Specifically, following this initial section introducing the article, Section 2 discusses the purpose of the basis consistency requirement; Section 3 sets forth and evaluates the basis consistency rules as interpreted by the proposed regulations, including the controversial zero basis rule; Section 4 sets forth the parameters for application of the rule; and section 5 sets forth and evaluates the efficacy of the consistent basis reporting requirements.

§ 1.02 Basis Consistency Rule and Its Purpose

Effective for returns filed after July 31, 2015,[9] Code Section 1014(f), for the first time, mandates use of estate tax value, as finally determined, for purposes of determining income tax basis of property acquired from a decedent. The mandate, however, applies "only" to property "whose inclusion in the decedent's estate increased the liability for" estate tax imposed as reduced by allowable credits.[10] The limitation, referenced in the statute as an "exception," indicates Congressional intent that the consistent basis rule only apply in situations where the Internal Revenue Service could be whipsawed, with the estate using one value for estate tax purposes and later, after the limitations period passes, the beneficiary using another for the determination of income tax basis.

[1] Perceived Need for Basis Consistency Requirement

Congress enacted the basis consistency rules and reporting requirements, in part, as revenue raising provisions for highway funds under the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015,[11] and, in part, to close a perceived loophole in the Code.[12] The perceived loophole derives from the lack of any previously statutorily required connection as between the fair market value reported by an estate for purposes of determining the Federal estate tax owed and the fair market value used by a decedent's beneficiary for purposes of determining income tax gains, depreciation deductions and the like. For purposes of determining Federal estate

[7] Prop Treas Reg § 1.6035-1(f).
[8] Prop Treas Reg § 1.1014-10(c)(3)(i)(B).
[9] Pub L No. 114-41, Title II § 2004(d), 129 Stat 454 (2015)(effective for returns filed after date of enactment which was July 31, 2015); Notice 2015-57, 2015-36 IRB 294.
[10] IRC § 1014(f).
[11] Pub L No. 114-41, Title II § 2004(a), 129 Stat 454 (2015).
[12] Unless otherwise specified, all references to the "Code" are to the Internal Revenue Code of 1986, as amended.

tax owed, the gross estate includes assets based on value as of the date of decedent's death.[13] The beneficiary who acquires property from a decedent, in general, takes a basis equal to the fair market value of the property as of decedent's date of death.[14] Despite the similarity of the statutory language requiring use of fair market value at date of death for determining both the gross estate and income tax basis in the hands of decedent's beneficiary, the income tax statute, prior to enactment of the basis consistency rules, did not require use of the same value by decedent's estate and by the beneficiary. Case law and the Service's rulings do address the situation. In fact it would be incongruous to call this a loophole in light of the long-standing revenue ruling promulgated by the Internal Revenue Service acknowledging that estate tax value is the "presumptive" value for income tax purposes.[15] The Revenue Ruling characterizes the estate tax value as "a presumptive value which may be rebutted by clear and convincing evidence."[16]

Given that for many assets value is difficult to determine and often depends on the valuation method and assumptions used by the appraiser, an estate and its beneficiary could conceivably obtain valuations from two different appraisers yielding substantially different date of death values. A decedent's estate would prefer the appraisal determining a lower date of death value and a decedent's beneficiary would favor the appraisal arriving at the higher date of death value. In fact, given that the revenue ruling acknowledging use of estate tax value for basis is presumptive only, in more than one informal poll taken at various gatherings of estate tax attorneys, when asked if they knew of estates asserting one value for estate tax purposes and beneficiaries asserting a different value for income tax purposes, a handful of attorneys each time raised their hands. Although these informal polls indicate different positions are not widely asserted by estates and their beneficiaries, they do indicate some taxpayers have used differing values. This is borne out by case law.[17] The courts, in general, require use of the presumptive estate tax value to determine basis when taxpayer either does not contest the estate tax value or where taxpayer is estopped from asserting a different value because of his or her prior representation, or the representation of a person with whom taxpayer is "in privity"[18] Given the narrow application of the basis consistency rule, it remains to be seen whether courts will continue to apply the law as it existed prior to enactment of the basis consistency rule to values reported on an estate tax return, but to which the newly enacted basis consistency rules do not apply; for example, the rule is not applicable to property generating a

[13] IRC § 2031; Treas Reg § 20.2031-1(b).
[14] IRC § 1014(a).
[15] Rev Rul 54-97, 1954-1 CB 113.
[16] *Id*. *See also* Janis v. Comm'r, 469 F3d 256 (2d Cir 2006) (holds taxpayer must use estate tax value in the absence of proof to the contrary); Levin v. United States, 373 F.2d 434 (1st Cir. Mass. 1967) (holds Service to its ruling position).
[17] *See, e.g.,* Swift v Wheatley, 538 F2d 1009 (3d Cir 1976) (taxpayer rebuts presumption); Griffith v United States, 1971 US Dist LEXIS 14943 (ND Tex 1971) (taxpayer estopped from changing value because taxpayer made representation on estate tax return, and is estopped from changing that representation following the running of the limitations period). *See also* Van Alen v. Comm'r, TC Memo 2013-235 (addressed duty of consistency in light of rules applicable to the making of the special use valuation election).
[18] American College of Trust and Estate Counsel Comments on Proposed Rules on Consistent Basis Reporting Between Estate, Person Acquiring Property From Decedent submitted May 27, 2016.

marital or charitable deduction even though the value is reported on the estate tax return and generates a deduction that impacts the determination of tax owed.[19]

The practical lesson to be derived from this background, of course, is that beneficiaries of decedent's estates not required to file an estate tax return will clearly prefer for income tax purposes an appraisal producing the highest reportable value. For estates required to file an estate tax return, executors should be sensitive to the counter-balancing tax implications as between income and estate tax and as among the beneficiaries when negotiating value in an audit. Executors generally have a duty of impartiality as among beneficiaries. Treasury indicates state law governs any remedy a beneficiary may have regarding value and declines to address this issue.[20]

[2] The President's Proposal

In response to the perceived opportunity to use one value for estate tax purposes and another for income tax basis purposes, President Obama's budget for 2015 called for basis consistency reporting. Specifically, his budget indicates:

> 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 basis of property received by gift during the life of the donor must equal the donor's basis determined under section 1015. The basis of property acquired from a decedent to whose estate section 1022 is applicable is the basis of that property, including any additional basis allocated by the executor, as reported on the Form 8939 that the executor filed. 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 and on the donor of a lifetime gift to provide the necessary valuation and basis information to both the recipient and the IRS.
>
> 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 or gifts are excluded from gift tax under section 2503, 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 event of adjustments to the reported value subsequent to the filing of an estate or gift tax return.
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> The proposal would be effective for transfers after the year of enactment.[21]

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[19] IRC § 1014(f)(2); Prop Treas Reg § 1.1014-10(b)(2).
[20] 2016-12 IRB 473 (Preamble to proposed regulations, paragraph 16).
[21] General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals, Dept. of Treasury, at p. 195-196 (Feb. 2015), https://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2016.pdf (accessed Jan. 10, 2016).

Congress did not adopt the broad reach urged by President Obama's proposal, but narrowed it in key respects. First, it limited reporting to executors of decedent's estate.[22] It, thus, eliminated any specific requirement to report basis on the making of a gift. Second, it limited reporting to those estates required to file a federal estate tax return.[23]

[3] Purpose as Explained by Treasury

In the preamble to the proposed regulations, Treasury indicates the underlying purpose of the basis consistency and corollary reporting requirements is "to achieve consistency between a recipient's basis in certain property acquired from a decedent and the value of the property as finally determined for estate tax purposes."[24] In explaining its decision to impose reporting requirements beyond the statutory framework enacted by Congress, Treasury highlights a monitoring purpose: "The purpose of this reporting is to enable the IRS to monitor whether the basis claimed by an owner of the property is properly based on the final value of that property for estate tax purposes."[25]

Interestingly, Treasury specifically acknowledges dual purposes underlying the basis consistency reporting rules, one of which is to create a system for monitoring basis. Arguably, the lack of any existing and cohesive basis monitoring system was one of the reasons that the 2010 repeal of the estate tax in favor of a carry-over basis regime failed to take hold. One could speculate that the basis consistency rules may in fact yield the infrastructure necessary to eventually make the move to a carry-over basis regime and away from an estate tax should Congress try a second time to make the shift.[26]

§ 1.03 The Basis Consistency Rule

The basis consistency rule, codified as I.R.C. Section 1014(f), places an upper limit on I.R.C. Section 1014 basis. It does not set forth the rule for determining basis, that job is left to I.R.C. Section 1014(a) which pegs basis at the "fair market value of the property at the date of decedent's death."[27] If an alternate valuation election, special use valuation election or conservation easement exclusion election is made, Section 1014 basis is as determined under those sections.[28] Thus, the basis consistency rules do not impact determination of basis under the longstanding rules of I.R.C. § 1014 except to set as the upper limit for basis in the hands of certain persons acquiring property from a decedent that value as finally determined for estate tax purposes. To better understand the

[22] IRC §§ 1014(f), 6035.
[23] IRC §§ 1014(f), 6035.
[24] 2016-12 IRB 473 (Preamble to proposed regulations, background).
[25] 2016-12 IRB 473 (Preamble to proposed regulations, paragraph 13).
[26] *See* IRC § 1022; *Also note*: In 1976, Congress previously enacted and then retroactively repealed a carry-over basis. If this attempt to move to a carry-over basis regime of some sort is counted, then the next attempt to do so will be the third, and, as the saying goes, the third time is often the charm. *See* The Tax Reform Act of 1976, Pub L No 94-455, § 2005, 90 Stat 1872 (1976), enacted carry-over basis on decedent's death, and The Crude Oil Windfall Profit Tax of 1980, Pub L No 96-223, 94 Stat 229 repealed its enactment.
[27] IRC § 1014(a)(1).
[28] IRC § 1014(a)(2)–(4).

ambiguities and arguable overreaching of the proposed regulations, attention must be paid to the subtle twists between the plain language of the statute as enacted by Congress and the extrapolated language of the proposed treasury regulations.

[1] Setting a Cap on Section 1014 Basis

In imposing the basis consistency requirement, Congress set a limit on basis in the hands of a recipient of property by mandating basis "shall not exceed" (a) "in the case of property the final value of which has been determined for purposes of" the estate tax "that value," and (b) "in the case of [other] property… with respect to which a statement has been furnished under" the basis consistency reporting rules "identifying the value of such property, such value."[29] The statute specifies the meaning of when "the basis of property has been determined" for purposes of the estate tax.[30] Specifically, it indicates as a beginning point that "the basis of property has been determined *if* – [] the value of such property is *shown on a return* under Section 6018 and such value is not contested by the Secretary before the expiration of the time for assessing [estate tax]…."[31] For the basis consistency limitation to apply, the value of the property must first be shown on an estate tax return. The reference to I.R.C. Section 6018 further infers that the basis consistency rules apply only to reporting of value on those estate tax returns required to be filed."[32] Alternatively, for the basis consistency limitation to apply, the value must be reported on a statement furnished pursuant to the consistent basis reporting rules. The basis consistency reporting requirement likewise cross-references I.R.C. Section 6018. The plain wording of the statute, thus, seems to require an actual reporting of value by the taxpayer to trigger the basis consistency limitation.

In addressing the determination of final value the statute also provides for alternative methods of arriving at final value. If the IRS determines a different value and the taxpayer does not timely contest, then it is at that point that the "basis of property has been determined."[33] If instead the value is determined "by a court or pursuant to a settlement agreement with the" IRS, it is then that the "basis of property has been determined."[34] Each alternative for determining whether "the basis of property has been determined" under the statute hinges on an initial reporting by the decedent's executor of the value of the property or an assertion of a different value by the IRS. The proposed regulations clarify that even under the alternatives provided by statute, value is not "final" for purposes of determining basis until the period of limitations for assessment has run or a decision of the parties or the court is made "final."[35] It makes sense to require value to be shown on a return or otherwise finally determined if the purpose of the statute as indicated in the preamble to the

[29] IRC § 1014(f)(1).
[30] IRC § 1014(f)(3).
[31] IRC § 1014(f)(3)(A).
[32] IRC § 6018.
[33] IRC § 1014(f)(3)(B).
[34] IRC § 1014(f)(3)(C).
[35] Prop Treas Reg § 1.1014-10(c).

proposed regulations is to ensure consistent reporting of value for purposes of both the estate and the income tax. Absent reporting and final determination of value for estate tax purposes, there is no need to employ consistency rules as I.R.C. Section 1014 would then simply apply to determine basis of the property at its fair market value as of decedent's death in the same manner that it continues to do with respect to property carved out from application of basis consistency rules.

[2] Zero Basis Rule per Regulations

Despite the plain wording of the statute applying the basis consistency limitation by its terms only "if" the value of property is "shown" on a required estate tax return,[36] the proposed treasury regulations apply a zero basis rule to after-discovered or otherwise omitted property from the return. With respect to that property, arguably, no final determination of value has been made, and as such it would fall outside the reach of the statute as enacted by Congress. The proposed regulations, nevertheless, assign a zero basis to after-discovered or omitted property not "shown" on an estate tax return.

The zero basis rule is not found in the statute. It is a creature of the proposed regulations. Pursuant to the regulations, the zero basis rule applies to "after discovered or omitted property" not reported on a required estate tax return.[37] Proposed regulations provide separate rules in the event the estate files a return but omits reporting property, as opposed to the instance where no estate tax return is filed. When property is discovered after the filing of the return or is otherwise omitted from assets reported on the initial estate tax return filed prior to the expiration of the estate tax assessment period, the after-discovered or omitted property takes a zero basis unless a "supplemental return" reporting the asset is filed prior to the running of the assessment period.[38] If the assessment period has run, the asset takes a zero basis in the hands of the recipient.[39] In this instance the beneficiary has no recourse. In the event no estate tax return has been filed by an estate that is required to file a return, property takes a zero basis in the hands of the recipient of the property from decedent until such time that a return is filed or a final value determined by the IRS.[40]

Treasury provides two examples explaining the zero basis rule – first, one where an initial estate tax return is filed, and, second, one where no return is filed.

> **Example A**. Executor is required to file an estate tax return and does so reporting decedent's residence at $695,000. After expiration of the estate tax assessment period, executor discovers property that was not reported on the estate tax return. The basis of the residence

[36] IRC § 1014(f)(3).
[37] Prop Treas Reg § 1.1014-10(c)(3). *See discussion,* Burke, J. Martin, Friel, Michael, Gagliardi, Elaine, Modern Estate Planning 2nd Ed., Ch. 69 (Lexis Publishing 2002).
[38] Prop Treas Reg § 1.1014-10(c)(3)(i)(A).
[39] Prop Treas Reg § 1.1014-10(c)(3)(i)(B).
[40] Prop Treas Reg § 1.1014-10(c)(3)(ii).

> remains at $695,000. Because the assessment period has run, the basis of the after discovered property is zero.[41]
>
> **Example B.** If before discovering the property, executor was not required to file a return because the filing threshold had not been exceeded, but after discovery of the property executor determines decedent died with a taxable estate. All property takes a zero basis until such time as executor files a return reporting property.[42]

The proposed regulations do not provide an example discussing the filing of a supplemental estate tax return, as referenced in the proposed regulations.

The reference in the proposed regulations to a supplemental estate tax return is confusing and raises a question as to its impact on the limitations period. Treasury regulations allowing extensions of estate tax returns specifically provide: "The [estate tax] return cannot be amended after the expiration of the extension period although supplemental information may subsequently be filed that may result in a finally determined tax different from the amount shown as the tax on the return."[43] Notably the 2015 Instructions to the 706 indicate the procedure for filing a supplemental estate tax return regardless of the prior lack of statutory or regulatory authority for amending the estate tax return. Although the Code extends the income tax limitations period for an additional 60 days if supplemental filing is made within 60 days of the running of the limitations period, there is no corollary statutory extension for estate taxes.[44] The zero basis rule as drafted, thus, would encourage filing of supplemental information as near as possible to the running of the estate tax limitations on assessment. Keep in mind, however, if on the estate tax return as filed there is a substantial omission exceeding 25 percent of the stated gross estate, the time for assessment is extended to six years from the time the return is filed.[45]

The zero basis rule arguably goes beyond the purpose of the statute and sneaks in an enforcement tool that essentially penalizes beneficiaries for receiving after-discovered property. It is not unusual that on occasion property is later discovered through no one's fault, intentional or otherwise. The comments by the American College of Trust and Estate Counsel (ACTEC) characterize application of the zero basis rule as causing a "forfeiture" of basis,[46] and the American Institute of CPAs (AICPA) as a "punitive overreach."[47] These characterizations seem appropriate as the zero basis

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[41] Prop Treas Reg § 1.1014-10(e), example 3(i).
[42] Prop Treas Reg § 1.1014-10(e), example 3(ii).
[43] Treas Reg § 20.6081-1(d) (revised February 3, 2016).
[44] IRC § 6501(c)(7).
[45] IRC § 6501(e)(2).
[46] American College of Trust and Estate Counsel Comments on Proposed Rules on Consistent Basis Reporting under Sections 1014(f) and 6035 (submitted May 27, 2016), available at http://www.actec.org/resources/government-relations/ (last accessed June 7, 2016).
[47] American Institute of CPAs Comments on proposed Rules on Consistent Basis Reporting Between Estates and Beneficiaries (submitted June 1, 2016), available at https://www.aicpa.org/InterestAreas/PersonalFinancialPlanning/CPEAndEvents/Pages/Estate-Basis-Consistency.aspx (last accessed June 24, 2016).

rule essentially operates as a disguised penalty for those beneficiaries who get trapped in its claws without sufficient time to request the executor correct the omission. The zero basis rule added by Treasury yields a stiff cost for after-discovered property over and above the penalties which already exist. Those penalties include the accuracy related penalties applicable to non-inclusion of assets on the estate tax return,[48] possible associated penalties imposed on executors and attorneys,[49] and the penalties specifically enacted in relation to the consistent basis rule. Congress explicitly designed penalties to encourage enforcement of basis consistency rules, including a targeted accuracy related penalty for reporting "an inconsistent basis" and penalties for non-reporting by an executor.[50] Although not characterized by the proposed regulations as a penalty per se, it is difficult to argue the zero basis rule is anything but punitive given the fact that it imposes a substantial cost on a beneficiary which conceivably could be in excess of the date of death value of the property itself and which is not contemplated or required by the language of the statute. Acknowledging the concerns of ACTEC and the AICPA, American Bar Association's Section of Taxation, in its comments, requests Treasury include a mechanism for dealing with property discovered after expiration of the limitations period.[51]

Despite the fact that the statute does not specifically or impliedly suggest a zero basis rule and despite the fact that the rule clearly exceeds the specific grant of regulatory authority to provide for exceptions to the application of the consistent basis rule[52] and very likely beyond the broader interpretive authority provided by the Code,[53] the general "duty of consistency" in tax reporting as developed by case law may be sufficient to persuade a court to uphold the zero basis regulation were it to be challenged. The Tax Court recognizes and describes the duty of consistency as follows:

> The "duty of consistency" is based on the theory that the taxpayer owes the Commissioner the duty to be consistent with his tax treatment of items and will not be permitted to benefit from his own prior error or omission. [Citation omitted]. The duty of consistency doctrine prevents a taxpayer from taking one position one year and a contrary position in a later year after the limitations period has run on the first year.[54]

The Eighth Circuit applied the duty of consistency to prevent a taxpayer who was the executor from asserting a different date of death value for purposes of the estate tax return and reporting of capital gain.[55] Although the zero basis rule does not contemplate the taxpayer taking contrary positions as

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[48] IRC § 6662(b)(5) and (h).
[49] *See* IRC § 6694(a) and (b).
[50] IRC § 6662(a) and (b)(8).
[51] *See* ABA Section of Taxation Comments on Consistency in Basis Proposed Regulations (submitted June 20, 2016), available at http://www.americanbar.org/groups/taxation/policy.html (last accessed June 28, 2016).
[52] IRC § 1014(f)(4).
[53] IRC § 7805(a).
[54] LeCompte v Comm'r, TC Memo 2015-39 (c*iting* LeFever v Commissioner, 103 TC 525, 541-542 (1994), aff'd, 100 F3d 778 (10th Cir 1996)).
[55] Beltzer v United States, 495 F2d 211 (8th Cir Neb 1974).

there would have been no reporting or position taken with respect to the omitted property, a court could imply that by not including the property on the return, the taxpayer in essence takes a contrary position. Nevertheless it may be that case law is better suited to addressing the issue of after-discovered or omitted property than the rule as set forth by the proposed regulations, especially in light of the fact that the statutory scheme presumes a determination of final value which cannot occur if the property is after-discovered or omitted. A court could take into account a number of factors including whether the beneficiary subject to the zero basis rule should be bound by the representation, or in this case lack of a representation as to the omitted asset's value, made by the executor.[56] The executor avers that the estate tax return is complete, but the executor can make this representation in good faith not knowing an asset will thereafter be discovered. There is an inherent unfairness in penalizing an executor who unintentionally omits an asset from the estate tax return or a beneficiary who may have taken no part in decisions made to marshal or report assets. Courts imposing the duty of consistency typically pay close attention to whether the representation should be attributed to and bind a taxpayer different than the one initially making the representation. The zero basis rule does not allow room for this consideration.

Until the regulation is successfully challenged, the executor or other person required to file a return, should make every effort to ensure reporting of all property includible in the gross estate both on the estate tax return and the return to report consistent basis. To ensure as complete reporting as possible, it may be beneficial for the executor to request an extension to file so that any limitations period on assessment does not begin for an additional six months following date of death, essentially allowing the executor more than four years from date of death to discover assets and to make any supplemental reporting required to avoid the zero basis rule. In light of the potential costs imposed by the zero basis rule, a fiduciary should carefully document the due diligence taken in discovering and marshalling assets of an estate.

[3] Adjustments to Basis Allowed

The proposed regulations clarify that post-death adjustments to basis for items such as depreciation or capital improvements should be reflected in basis used to determine income tax consequences in the hands of the beneficiary. The initial basis, thus, may thereafter be adjusted pursuant to other provisions of the Code without violating the basis consistency requirements and without triggering application of the associated penalty provisions.[57] Proposed regulations contemplate initial basis will be adjusted for post-death events to reflect "gain recognized by the decedent's estate or trust upon distribution of the property, post-death capital improvements and depreciation, and post-death adjustments to the basis of an interest in a partnership or S corporation…."[58] The regulations explain using an example.

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[56] *See, e.g.,* Van Alen v Comm'r, TC Memo 2013-235.
[57] Prop Treas Reg § 1.1014-10(a)(2); Prop Treas Reg § 1.6662-8(b) (referencing IRC § 6662(k)). *See discussion,* Burke, J. Martin, Friel, Michael, Gagliardi, Elaine, Modern Estate Planning 2nd Ed., Ch. 69 (Lexis Publishing 2002).
[58] Prop Treas Reg § 1.1014-10(a)(2).

> **Example.** Chelsea inherited her home with an initial basis determined under the basis consistency rules of $650.000. She adds a master suite to her home for the cost of $45,000. On making the capital improvement to her home, I.R.C. Section 1016(a), would increase her initial basis by $45,000 to $695,000. Chelsea then decides to sell her home to an unrelated third party for $900,000. Chelsea claims a basis in the home of $695,000 and for income tax purposes reports a gain of $205,000 ($900,000 – $695,000). Chelsea has complied with the basis consistency requirement.[59]

Payments made on debt secured by property subject to the basis consistency rules, whether the underlying debt is recourse or non-recourse debt, will not impact basis.[60] On an estate tax return, if debt is non-recourse only the net fair market value is included in the gross estate, whereas, if debt is recourse, the full fair market value of the property is includible in the gross estate. The proposed treasury regulations, unfortunately, fail to clarify that initial basis in the case of property subject to nonrecourse debt is the underlying fair market value of the property plus the nonrecourse debt and only do so by way of example.[61]

> **Example:** At Destiny's death, she owned 50 percent of Highpark Partnership, which owned a rental building with a fair market value of $10 million subject to nonrecourse debt of $2 million. Destiny's sole beneficiary is her child Camp. Highpark Partnership is valued at $8 million. Destiny's interest in the partnership is reported on the required estate tax return at $4 million. The IRS accepts the return as filed and the time for assessing estate tax expires so that value is finally determined for purposes of the basis consistency rules. Camp sells the interest devised to him for $6 million in cash shortly thereafter. Camp's basis in the interest in Highpark Partnership at the time of its sale is $5 million (i.e., the final value of Destiny's interest ($4 million) plus 50 percent of the $2 million nonrecourse debt).[62] Following the sale of the interest, Camp reports taxable gain using $5 million as basis. Camp has complied with the basis consistency requirement.[63]

It would be helpful if Form 8971 and its instructions clarified reporting to provide clear indication of date of death fair market value for beneficiaries inheriting property subject to non-recourse debt.[64] Lack of clarification will likely lead to confusion, not only on the part of the beneficiary, but also on the part of any computer program used by the Service to track consistent basis reporting.

[4] Accuracy Related Penalties Imposed on Beneficiary

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[59] Prop Treas Reg § 1.1014-10(e), example 2(ii).
[60] Prop Treas Reg § 1.1014-10(a)(2).
[61] Prop Treas Reg § 1.1014-10(e), example 1.
[62] Prop Treas Reg § 1.1014-10(e), example 1 (references IRC § 742; Treas Reg §1.742-1).
[63] Prop Treas Reg § 1.1014-10(e), example 1.
[64] *See* American College of Trust and Estate Counsel Comments on Proposed Rules on Consistent Basis Reporting under Sections 1014(f) and 6035 (submitted May 27, 2016), available at http://www.actec.org/resources/government-relations/ (accessed June 7, 2016).

The basis consistency rules raise the specter of additional penalties for unwitting beneficiaries in the event final value proves different than that originally reported. The preamble to the proposed regulations explains reporting prior to the determination of final value:

> If no final value has been determined when the taxpayer's basis in the property becomes relevant for Federal tax purposes, for example, to calculate depreciation or amortization, or to calculate gain or loss on the sale, exchange or disposition of the property, the taxpayer uses the value reported on the statement required by section 6035(a) (the fair market value reported on the Federal estate tax return) to determine the taxpayer's basis for Federal tax purposes.[65]

Yet at the same time the proposed regulations imply that if the recipient complies with the regulations and in fact uses the value reported on the statement provided by the executor, the recipient, who many times will have had nothing to do with setting the value reported, will nevertheless be subject to the consequences of an accuracy related penalty for inconsistent reporting of basis. The proposed regulation states that, if final value differs from the value on the initial consistent basis reporting statement provided to the beneficiary, "then the taxpayer may not rely on the statement initially furnished under section 6035(a) for the value of the property and the taxpayer may have a deficiency and underpayment resulting from this difference."[66] An accuracy related penalty applies to an "inconsistent estate basis"[67] which arises if basis "claimed on a return exceeds its final value as determined."[68] To clear up any possible ambiguity in the interpretation of this penalty, it would be helpful, and relieve the possibility of unfairness that would result to a beneficiary who relied as required on the most current supplemental statement value, if the proposed regulations setting forth application of the accuracy related penalty were changed. The clarification should provide that, if at the time the beneficiary reports income tax consequences dependent on basis the beneficiary reports those tax consequences based on the most current statement provided to the beneficiary, that statement is per se "substantial authority" sufficient to eliminate any asserted underpayment that would trigger the accuracy related penalty. Such relief would be important regardless of whether the beneficiary was also the executor.

§ 1.04 Property Subject to the Basis Consistency Rule

Not all property reported on a required estate tax return is subject to the basis consistency rule. In describing the new statutory framework, Treasury differentiates the scope of the basis consistency rule under I.R.C. Section 1014(f) and the consistent basis reporting requirement under I.R.C. Section 6035. Specifically it highlights that the basis consistency rule of §1014(f) applies only to that property included in the gross estate that causes an increase in federal estate tax liability; whereas, 6035 requires reporting of "the value of property included on a required Federal estate tax

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[65] Prop Treas Reg § 1.1014-10, 2016-12 IRB 473 (Summary of comments on Notice 2015-57, paragraph 1).
[66] Prop Treas Reg § 1.1014-10(c)(2).
[67] IRC § 6662(b)(8).
[68] IRC § 6662(k). *See also* Prop Treas Reg § 1.6662-8(a) and (b).

return."[69] The consistent basis reporting requirement, thus, encompasses a broader range of assets than does the basis consistency rule, which imposes the limit on basis.

[1] Included and Excluded Property

Subject to certain additions and exclusions, the basis consistency rule generally applies to property meeting the following requirements:

(1) the property is included in the gross estate;
(2) it was shown on a "required" estate tax return, and
(3) it "increased the liability" for estate tax.[70]

The requirements that the property be included in the gross estate and increase the liability for estate tax come from the plain wording of the statute indicating the basis consistency rule "shall *only* apply to any property whose inclusion in the decedent's estate increased the liability for the [estate] tax…."[71] The requirement that the property be indicated on a required return derives from the fact that the basis limit initially depends on final value as shown on the return.[72] Proposed regulations interpret these requirements to encompass property includible in the gross estate of a U.S. citizen and that property included in the gross estate (and situated in the United States) of a nonresident alien.[73]

The proposed regulations expand application of the basis consistency rule to apply to other property, as well. The expanded coverage of the regulations includes property if its basis is determined in whole or part by reference to the basis of property that was included in the gross estate and subject to the basis consistency requirement. The regulations give as examples property received in a like-kind exchange or involuntary conversion. Because basis of property received in a like-kind exchange or an involuntary conversion is specifically determined under corresponding statutes and regulations, the regulatory expansion of the basis consistency rule to this property proves more confusing than helpful.

The proposed regulations further clarify that certain property is excluded from the reach of the basis consistency rule because it does not increase the liability for estate tax. The regulations also *deem* certain property excluded as not increasing such liability. Specifically, the following property is excluded from application of I.R.C. Section 1014(f):

(1) Property qualifying for a charitable deduction pursuant to I.R.C. Section 2055;
(2) Property qualifying for a marital deduction pursuant to I.R.C. Section 2056 or pursuant to I.R.C. Section 2056A, referencing property held in a qualified domestic trust, often called a QDOT;
(3) Tangible personal property for which an appraisal is not required under §20.2031-6(b), as

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[69] 2016-12 IRB. 473 (preamble to proposed regulations, paragraph 2).
[70] IRC § 1014(f)(2). *See discussion*, Burke, J. Martin, Friel, Michael, Gagliardi, Elaine, Modern Estate Planning 2nd Ed., Ch. 69 (Lexis Publishing 2002).
[71] IRC § 1014(f)(2).
[72] IRC § 1014(f)(1)(A); IRC § 1014(f)(3)(A).
[73] Prop. Treas. Reg. § 11014-10(b)(1)(cross-references I.R.C. § 2106).

discussed below.

Martial and charitable deduction property is excluded from application of the basis consistency requirement because it does not increase the ultimate estate tax payable.[74] Tangible personal property is "deemed" not to do so.[75] This additional exclusion is authorized by the statute which allows Treasury to provide additional exceptions to application of the basis consistency requirement.[76]

[2] Ambiguity as to Application

The basis consistency statute, I.R.C. Section 1014(f) limits application of the consistency requirement "only … to any property whose inclusion in the decedent's estate increased the liability for the [estate] tax imposed … (reduced by credits allowable against such tax) on such estate."[77] This language is confusing and can be interpreted in more than one way as evidenced by the proposed regulations.[78] The confusion stems from the fact that I.R.C. Section 1014 refers to "credits allowable" whereas the I.R.C. Section 6035 reporting rules are keyed to I.R.C. Section 6018, which takes into account only the credit in relation to the basic exclusion amount per I.R.C. Section 2010(c) for U.S. citizens and residents and the amount of $60,000 for nonresident aliens.[79] Adding to the confusion as to how to properly interpret the threshold for application of I.R.C. Section 1014(f) is the implication in the proposed regulations that Section 1014(f) applies only in the event estate tax is payable; specifically, in interpreting when I.R.C. Section 1014(f) applies the proposed regulations state:

> [If] a liability under chapter 11 is payable after the application of all available credits (other than a credit for a prepayment of estate tax), the consistency requirement … applies to the entire gross estate (other than property excluded under … this section) because all such property contributes to the [estate tax] liability [] and therefore is treated as generating a[n estate] tax liability [].
>
> *If, however, after the application of all such available credits, no [estate] tax [] is payable, the entire gross estate is excluded from the application of the consistency requirement.*[80]

(Emphasis added.) By couching application of the exception provided in Section 1014(f) in terms of whether an estate tax is payable, as opposed to whether a return is required to be filed, the proposed regulations do not track the statutory language and cause some confusion as to the proper interpretation of the basis consistency requirement. A return required to be filed may result in no estate tax payable for a number of reasons including deductions and credits in addition to the unified credit.

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[74] Prop. Treas. Reg. § 1.1014-10(b)(2). *See* I.R.C. § 1014(f)(2).
[75] Prop. Treas. Reg. § 1.1014-10(b)(2). *See* Prop. Treas. Reg. § 1.6035-1(b)(1)(iii)
[76] I.R.C. § 1014(f)(4).
[77] I.R.C. § 1014(f).
[78] *See discussion*, Burke, J. Martin, Friel, Michael, Gagliardi, Elaine, Modern Estate Planning 2nd Ed., Ch. 69 (Lexis Publishing 2002).
[79] *Compare* IRC § 1014(f)(2) *with* IRC § 6035(a)(1) (referencing IRC § 6018(a)).
[80] Prop Treas Reg § 1.1014-10(b)(3).

One interpretation of this statutory language, and the most logical, would reconcile the statutory application of I.R.C. Section 1014(f) in terms of the filing threshold applicable to I.R.C. Section 6035. Such an interpretation would make subject to the basis consistency requirement all property reported on an estate tax return required to be filed under I.R.C. Section 6018 except property that does not increase estate tax liability. Such an interpretation would apply the exception set forth in I.R.C. Section 1014(f)(2) with a focus on the word "property" and exclude from application of the basis consistency requirement property included in the gross estate and subject to an allowable marital or charitable deduction because such property would not lead to an increase in the estate tax ultimately owed. In fact the proposed regulations provide for such an exclusion for marital and charitable deduction property from the basis consistency requirement.[81] In addition the proposed regulations deem tangible personal property included in a decedent's gross estate for which an appraisal is not required to be excluded from application of the basis consistency requirement as well.[82] This interpretation seems most appropriate and would make consonant the application of I.R.C. Section 6035 and 1014(f) with the exception of marital and charitable deduction property. It would also give full effect to the meaning ascribed by I.R.C. Section 1014(f) to the term "determined for purposes of the 'estate tax'…" which the statute defines in terms of values included on an estate tax return filed pursuant to I.R.C. Section 6018.[83]

The proposed regulation quoted above suggests another interpretation and thereby raises a question—perhaps inadvertently-- as to the application of the basis consistency requirement under I.R.C. Section 1014(f). The regulation suggests that I.R.C. Section 1014(f) should be limited to those estates where an estate tax "is payable" when it indicates, as quoted above, that "if…after the application of all such available credits, no [estate] tax [] is payable, the entire gross estate is excluded from the application of the consistency requirement." That same sub-section of the proposed regulations begins by indicating: "if a[n estate tax] liability [] is payable after the application of all available credits…, the consistency requirement…applies to the entire gross estate (other than property excluded…)" The statutory language of I.R.C. Section 1014(f) differs slightly from that used in the proposed regulation, indicating instead the basis consistency rules: "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." The quoted proposed regulation shifts emphasis from the focus on "property" as per the statute to accentuate instead payment of estate tax. It is this shift in emphasis that unnecessarily creates confusion in the interpretation of when the basis consistency rules apply. The explanation as to application of the basis consistency rules provided in the preamble to the proposed regulation perpetuates this emphasis on whether estate tax is payable.

> The preamble states:
>
> The consistent basis requirement of section 1014(f)(1) applies only to property the inclusion of which in the decedent's gross estate for Federal estate tax purposes increases the Federal estate tax liability payable by the decedent's estate. Proposed §1.1014-10(b) defines this

[81] Prop Treas Reg § 1.1014-10(b)(2).
[82] Prop Treas Reg § 1.1014-10(b)(2).
[83] IRC § 1014(f)(3)(A).

> property as property includible in the gross estate under section 2031, as well as property subject to tax under section 2106, *that generates a Federal estate tax liability in excess of allowable credits*. The proposed regulations specifically exclude all property reported on a Federal estate tax return required to be filed by section 6018 if no Federal estate tax is imposed upon the estate due to allowable credits (other than a credit for a prepayment of that tax). *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. 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. Thus, *if any Federal estate tax liability is incurred*, all of the property in the gross estate (other than that described in the preceding two sentences) is deemed to increase the Federal estate tax liability and is subject to the consistency requirement of section 1014(f).[84]

This emphasis on incurring federal estate tax, as noted, is drawn from the language of the statute delineating exceptions to application of the basis consistency requirement. It remains to be seen whether the final regulations provide further clarification as to application of Section 1014(f) especially in light of the fact that an estate can have a reporting requirement but not pay any estate tax, either because of the marital or charitable deduction or because of the deductions for funeral expenses, administration expenses, or claims against the estate or because of the unified credit in conjunction with the credit for tax on prior transfers, the credit for foreign death taxes and the credit for tax on remainders. In fact, in discussing the zero basis rule, the examples indicate the zero basis rule applies only if the after-discovered asset would cause there to be a "taxable estate," which pursuant to the Code is defined as the gross estate less deductions, including deductions for funeral and administration expenses, state death taxes, charitable gifts eligible for the charitable deduction and transfers to spouses eligible for the marital deduction.[85] Perhaps property used to pay claims and expenses should likewise be excluded, or perhaps the proposed regulation as drafted anticipates this result. Property used to pay claims is not available for distribution. The question of whether I.R.C. Section 1014(f) applies is important not only for basis purposes, but also for purposes of determining the reporting penalty applicable pursuant to I.R.C. Section 6662.

§ 1.05 Consistent Basis Reporting Rules

To monitor and enforce the basis consistency rule, Congress enacted a separate reporting requirement effective for estate tax returns filed after July 31, 2015. The consistent basis reporting requirement covers a broader range of assets than does the basis consistency rule. In addition, the consistent basis reporting requirement, although triggered by the filing of an estate tax return, differs as to due date, events triggering the requirement, and the persons required to file the return.

After a series of extensions, Treasury set June 30, 2016 as the initial due date for filing Form 8971, "Information Regarding Beneficiaries Acquiring Property From a Decedent" and accompanying Schedule A to beneficiaries. Proposed regulations refer to the Form 8971 as the "information

[84] 2016-12 IRB 473 (Preamble to proposed regulations, paragraph 3) (emphasis added).
[85] Prop Treas Reg § 1.1014-10(e), example 3(ii). *See* IRC § 2051 for the definition of taxable estate.

return" and to Schedule A as the "statement" to the requisite beneficiaries.[86] In general, an executor who files a required estate tax return must also file a Form 8971, typically within 30 days of the filing of the estate tax return. In addition, treasury extended the reporting requirements to mandate subsequent reporting, including reporting by beneficiaries of decedent's property. The reporting requirement as configured in the proposed regulations extends the reporting requirements beyond those contemplated by Congress and does so in a manner suggested in Obama's budget proposal, but not adopted by Congress. Failure to report can trigger late filing penalties specific to the Form 8971.[87]

[1] Threshold for Reporting Requirements

The consistent basis reporting rules only apply if the estate tax return for decedent's estate is filed after July 31, 2015.[88] The reporting requirements apply based on the date the estate tax return is filed and not the date that the return was due.[89] Thus, an estate tax return due prior to July 31, 2015, but filed thereafter, will trigger the need to report for purposes of the consistent basis reporting requirement.

Statutorily, the consistent basis reporting requirement applies only to estates of decedent's required to file a federal estate tax return.[90] Thus, a Form 8971 and accompanying schedules A should only need to be filed in those instances where the date of death value of a U.S. citizen or resident decedent's assets includible in the gross estate exceeds an amount equal to the basic exclusion amount at decedent's death reduced by the aggregate of the amount of post-1976 adjusted taxable gifts and by the amount of specific exemption used from September 8, 1976 to December 31, 1976.[91] For estates of nonresident alien decedents, an estate tax return need be filed only to extent assets situated in the United States and includible in the gross estate exceed $60,000 decreased by the amount of adjusted taxable gifts and by specific exemption used after September 8, 1976.[92] Statistics show that very few estates are required to file a return each year as evidenced by the fact that only 36,000 estate tax returns of all types were filed in 2015.[93] Nevertheless for those estates subject to the consistent basis reporting requirements the added cost and time involved to meet and track the assets subject to the reporting requirements could prove substantial on both the part of the taxpayer and the Service.

Proposed regulations, in a welcomed clarification, exclude from reach of the consistent basis reporting requirements those Federal estate tax returns filed by estates of decedents not otherwise

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[86] Prop Treas Reg § 1.1014-10(g)(1) and (2).
[87] *See* Prop. Treas. Reg.
[88] Pub L No 114-41, Title II § 2004(d), 129 Stat 454 (2015); Notice 2015-57, 2015-36 IRB 294.
[89] *See* Prop Treas Reg § 1.6035-1(i). *See also* Notice 2015-57, 2015-36 IRB 294.
[90] IRC § 6035(a)(1) and (2).
[91] IRC § 6018(a)(1) and (3).
[92] IRC § 6018(a)(2).
[93] 2015 IRS Data Book, available at https://www.irs.gov/uac/soi-tax-stats-irs-data-book (last accessed June 7, 2016).

required to file an estate tax return.[94] Proposed regulations specifically exclude from the consistent basis reporting requirement:

(1) Estate tax returns filed for the purpose of making a GST allocation or election;
(2) Estate tax returns filed for the purpose of making a portability election, and
(3) Estate tax returns filed to make any protective filing to avoid penalties if value is later determined to cause a return to be required.[95]

The January 2016 instructions to the Form 8971, in setting forth "Who Must File," confusingly list qualified heirs among persons who must comply with consistent basis reporting requirements. Specifically the instructions impose a reporting requirement at the time a qualified heir files Form 706-A, Additional Estate Tax Return, to report the early cessation of a qualified use or an early disposition of property for which a special use valuation election was made.[96] The proposed regulations, however, do not mention any reporting requirement triggered by the filing of Form 706-A. Perhaps on a closer reading of the statute, Treasury determined that the reporting requirement should not apply to qualified heirs on the basis that the Form 706-A is not an estate tax return to which I.R.C. Section 6018 specifically applies. It remains to be seen if future instructions to Form 8971 and Schedule A withdraw this instruction making the reporting requirement applicable to qualified heirs.

[2] Assets Subject to Reporting Requirement

The consistent basis reporting requirement subjects to reporting on Form 8971 and the respective Statements A all property "reported or required to be reported" on the estate tax return, and not just that property subject to the basis consistency rule.[97] The regulations, thus, make subject to the reporting requirements property omitted from the estate tax return. This makes sense in light of the statutory language making "any interest in property included in the decedent's gross estate" subject to the consistent basis reporting requirements.[98] The proposed regulations clarify, however, that nonresident aliens need only report property subject to estate tax, which generally is property situated in the United States and includible in the gross estate.[99] Likewise, the regulations explain that only decedent's one-half community property interest included in the gross estate need be reported on Form 8971 and accompanying Schedules A.[100]

[94] Prop Treas Reg § 1.6035-1(a)(2).
[95] Prop Treas Reg § 1.6035-1(a)(2).
[96] Instructions for Form 8971 and Schedule A (issued January 2016).
[97] Prop Treas Reg § 1.6035-1(b)(1).
[98] IRC § 6035(a)(1).
[99] Prop Treas Reg § 1.6035-1(b)(1).
[100] Prop Treas Reg § 1. 6035-1(b)(1).

In a departure from the statute, the proposed regulations also include within property subject to the reporting requirement "any other property whose basis is determined in whole or in part by reference to" property required to be reported on decedent's federal estate tax return "(for example as the result of a like-kind exchange or involuntary conversion)."[101] Unlike with other extensions of the reporting requirements, Treasury does not provide any explanation or justification for expanding the reach of the reporting requirements to property resulting from a like-kind exchange or involuntary conversion that was not reported on the estate tax return. Arguably the expanded coverage falls within Congress' specific grant of regulatory authority to promulgate regulations applicable "to property with regard to which no estate tax return is required…."[102] Neither do Form 8971 nor its instructions specifically indicate how to report the value of this type of property on the Schedule A. None of the columns of schedule A have applicability to property not reported on the estate tax return – those columns ask for a description as reported on and valuation information from the estate tax return. How should reporting be made when the asset to be reported was never included in the gross estate? It is hoped that future versions of Form 8971 and accompanying instructions will provide guidance on reporting property with a basis determined by reference to property reported on the return.

The proposed regulations except from the reporting requirements the following types of assets that would otherwise be subject to the reporting requirements:

(1) Cash (but not a coin collection or any other coins or bills with numismatic value);[103]
(2) Income in respect of a decedent;[104]
(3) Tangible personal property for which an appraisal is not required when filing the federal estate tax return;[105] and
(4) "Property sold, exchanged, or otherwise disposed of (and therefore not distributed to a beneficiary) by the estate in a transaction in which capital gain or loss is recognized."[106]

Each of the exceptions makes eminent sense. Section 1014 specifically does not apply to determine basis of the right to receive income in respect of a decedent,[107] nor does cash have a basis per se. To be required to report a value for each item of tangible personal property when not even the estate tax return imposes such a burden would impose an unreasonable and unexpected burden on taxpayers. For that reason it makes practical sense to coordinate the rules for reporting tangible personal property for purposes of basis consistency and the federal estate tax return. Finally, property transferred in a manner recognizing gain or loss takes a new Section 1012 cost basis, and is

[101] Prop Treas Reg § 1.6035-1(b)(1).
[102] IRC § 6035(b)(2).
[103] Prop Treas Reg § 1.6035-1(b)(1)(i).
[104] Prop Treas Reg § 1.6035-1(b)(1)(ii).
[105] Prop Treas Reg § 1.6035-1(b)(1)(iii).
[106] Prop Treas Reg § 1.6035-1(b)(1)(iv).
[107] IRC § 1014(c).

no longer derived from basis under Section 1014. Proposed regulations specifically discuss some of these exceptions.

The proposed treasury regulations coordinate reporting of tangible personal property by cross-referencing the regulations indicating when an appraisal is required for items of tangible personal property reportable on the federal estate tax return.[108] The estate tax valuation regulations indicate an appraisal *is* required: "if there are included among the household and personal effects articles having marked artistic or intrinsic value of a total value 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."[109] The instructions to Form 706 clarify the $3000 reference refers to individual items or collections: "If any item or collection of similar items is valued at more than $3,000, attach an appraisal by an expert..." Examples provided in the proposed regulations discuss this in context of the basis consistency reporting requirements.

> **Example**. Denver's gross estate includes the contents of her residence. As required for estate tax return reporting purposes, Denver's personal representative attaches to the estate tax return a room by room itemization of household and personal effects. All items are specifically listed. 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. Included are a painting, a rug, and a clock, each of which has a value in excess of $3,000 and for that reason the personal representative obtains an appropriate appraisal for each of those items. The reporting requirements for basis consistency purposes apply only to the painting, rug, and clock.[110]

The exception from the consistent basis reporting requirements for property received in a transaction in which capital gain or loss is recognized also makes practical sense because on a sale or exchange in which capital gain is not only realized but recognized, basis no longer derives from I.R.C. Section 1014, but takes a cost basis pursuant to I.R.C. Section 1012. Some commentators interpret the reference to sale or exchange in which "capital gain is recognized" as requiring that an amount other than zero be recognized. Another way to interpret the recognition of gain requirement is to contrast it with those situations in the Code where gain may be realized but not recognized. The proposed regulations provide an example that is not dependent on the actual recognition of a gain or loss in excess of zero, but instead is dependent on the transaction being a "fully taxable" transaction as opposed to a tax-free merger where basis would be determined in a manner to preserve unrealized gain suggesting a broader interpretation that that of the commentator's is appropriate.

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[108] Prop Treas Reg § 1.6035-1(b)(1)(iii).
[109] Treas Reg § 20.2031-6(b).
[110] Prop Treas Reg § 1.6035-1(b)(2), example 1.

> **Example**. Included in Denver's gross estate are shares in Kodiak Corporation, a publicly traded company. Shortly after D's death, but prior to the filing of the estate tax return for D's estate, Tempest Corporation, also publicly traded, acquires Kodiak Corporation. As a result, in a fully taxable transaction, the estate receives Tempest shares and cash for its Kodiak shares. The basis consistency reporting requirements do not apply to the Tempest shares in light of the taxable sale or exchange.[111]

The example clarifies that it is the possibility of recognition of gain or loss that is important. In fact if property is sold near the date of decedent's death it is more likely than not that no gain will be recognized in light of basis equaling fair market value at death.

[3] Beneficiary Statements

The executor must furnish a statement, in other words, a Schedule A, to each beneficiary "*receiving*" property required to be reported on the estate tax return.[112] It leaves room to interpret the statement requirement to apply only to beneficiaries who in fact receive property. The proposed regulation, however, interprets the statutory requirement to mean that persons "*acquiring* any interest in property included in decedent's gross estate" receive a statement within 30 days of the filing of the estate tax return.[113] The statement must be furnished even if the executor is the beneficiary.[114] If the beneficiary is a trust, estate or other entity, the executor furnishes the statement to the respective trustee, executor or entity.[115] The statement is not furnished to the respective beneficiaries or owners of interests in the entity, but a further transfer by the trust, estate or entity can trigger a supplemental reporting requirement.[116] This last provision of the regulations may prove important for planning purposes because, if at the time the information return and statement become due the property to be received by the beneficiary has not been determined, the statement to the beneficiary must report all property that could be used to satisfy the interest the beneficiary is to receive.[117] This requirement is likely to cause misunderstandings and confused expectations on the part of beneficiaries.

Proposed regulations specifically provide reporting requirements to beneficiaries of partial interests. If the interest transferred is a life estate or remainder interest, the executor furnishes the statement (Schedule A) to both the life tenant and to the remainder-person who would receive the property if the life tenant died immediately.[118] The proposed regulations also indicate that the "beneficiary of a

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[111] Prop Treas Reg § 1.6035-1(b)(2), example 2.
[112] Prop Treas Reg § 1.6035-1(c)(1).
[113] IRC § 6035(a)(1).
[114] Prop Treas Reg § 1.6035-1(c)(1).
[115] Prop Treas Reg § 1.6035-1(c)(2).
[116] Prop Treas Reg § 1.6035-1(c)(2) (cross references Prop Treas Reg § 1.6035-1(f) for supplemental reporting requirements).
[117] Prop Treas Reg § 1.6035-1(c)(3).
[118] Prop Treas Reg § 1.6035-1(c)(2). *See discussion*, Burke, J. Martin, Friel, Michael, Gagliardi, Elaine, Modern Estate Planning 2nd Ed., Ch. 69 (Lexis Publishing 2002).

contingent interest is a beneficiary, unless the contingency has occurred prior to the filing of the Form 8971."[119] This last requirement may have practical implications that make it impossible to comply, for example, with respect to contingent beneficiaries that are not yet born or those that would take only on exercise or non-exercise of a limited or special power of appointment. Use of a trust, as opposed to a deed, to create these interests would side-step the need to provide multiple statements for an asset, with the only statement required being to the trustee of the trust until such time that distribution of the assets (as opposed to cash) from the trust is made to the beneficiaries.

It is incumbent on the executor to "use reasonable due diligence to identify and locate all beneficiaries."[120] If the executor is unable to locate the beneficiary, the executor must explain steps taken to locate the beneficiary on the Form 8971. If the beneficiary is thereafter located, a supplemental information return must be filed within 30 days of that date.[121] If the beneficiary is not located and property passes to a substitute beneficiary not originally identified in the information return as a recipient of the property, the executor must also file a supplemental information return and statement within 30 days after the property is distributed.[122] While the proposed regulations address the inability to locate a beneficiary, the regulations provide no relief for not being able to obtain identifying information required on the Form 8971 and Statements A for other beneficiaries. The executor has little leverage to demand this information when the reporting must be completed prior to the time that the beneficiary actually receives assets.

[4] Supplemental Reporting by Executor

In addition to the filing of an initial information return and accompanying statements, the statute requires the filing of supplemental information returns and statements.[123] Proposed treasury regulations clarify that an executor must complete supplemental reporting if a change occurs as "to the information required to be reported on the Information Return or Statement that causes the information as reported to be incorrect or incomplete."[124] Among the changes that trigger supplemental reporting, the regulations list the following:

(1) the discovery of property that was omitted from a required estate tax return;[125]
(2) a change in the value of property as a result of an examination or litigation;[126]
(3) a change in the identity of the beneficiary to whom the property is to be distributed, including as a result of a death, disclaimer, or bankruptcy);[127]

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[119] Prop Treas Reg § 1.6035-1(c)(1).
[120] Prop Treas Reg § 1.6035-1(c)(4).
[121] Prop Treas Reg § 1.6035-1(c)(4).
[122] Prop Treas Reg § 1.6035-1(c)(4).
[123] IRC § 6035(a)(3)(B); Prop Treas Reg § 1.6035-1(a)(1); Prop Treas Reg § 1.6035-1(e)(1).
[124] Prop Treas Reg § 1.6035-1(e)(2).
[125] Prop Treas Reg § 1.6035-1(e)(2).
[126]Prop Treas Reg § 1.6035-1(e)(2).
[127] Prop Treas Reg § 1.6035-1(e)(2).

(4) disposition by the executor of property acquired from or as a result of the death of the decedent in a transaction in which the basis of the newly acquired property received is determined in whole or in part by reference to the property originally held (e.g., property received in a like-kind exchange or involuntary conversion).[128]

None of the changes requiring supplemental reporting qualify "as inconsequential errors or omissions."[129]

Proposed regulations further clarify that supplemental reporting by an executor is not required in certain situations. The regulations enumerate two such circumstances:

(1) To correct an "inconsequential error or omission;" or
(2) To set forth the actual distribution of property previously reported as available to satisfy the interests of multiple beneficiaries.

While the second enumerated exception relieves the need for a second statement filing on actual distribution of property, it does nothing to relieve the confusion that is generated by the initial filing requirement reporting assets to a beneficiary that they will never receive.[130] It would seem to make more sense, both for purposes of allowing the Service to track assets and to avoid unnecessarily raising expectations of beneficiaries, to postpone the due date for mailing a Schedule A to a beneficiary until such time as distribution is made to a beneficiary and title transferred.[131] To the extent property has not transferred from the executor to a beneficiary as of the due date of the Form 8971, it would make sense to send the initial Schedules A to the person holding title to decedent's assets, even if that person is the executor. It is the person holding title to the assets that is in receipt of the assets at that time. Treasury, however, has rejected this more practical option in favor of reporting on schedule A events that may never in fact occur and forgoing a record of what in fact occurs.

As to the first exception referencing "inconsequential error or omission," that term is defined in the following manner: "any failure that cannot reasonably be expected to prevent or hinder the payee from timely receiving correct information and reporting it on his or her return or from otherwise putting the statement to its intended use."[132] Misstatement of a dollar value or significant identifying information of the beneficiary are specifically listed as "never" "inconsequential."[133] Recognizing that a beneficiary is much more likely to provide requested information such as the beneficiary's identification number at the point that the beneficiary expects to receive assets from

[128] Prop Treas Reg § 1.6035-1(e)(2).
[129] Prop Treas Reg § 1.6035-1(e)(2) (cross references Treas Reg § 301.6722-1(b)).
[130] *See* Prop Treas Reg § 1.6035-1(e)(3)(i)(B) (cross referencing Prop Treas Reg § 1. 6035-1(c)(3)).
[131] *See* American College of Trust and Estate Counsel Comments on Proposed Rules on Consistent Basis Reporting under Sections 1014(f) and 6035 (submitted May 27, 2016), available at http://www.actec.org/resources/government-relations/ (last accessed June 7, 2016) (making a similar argument for reporting at time of distribution).
[132] Treas Reg § 301.6722-1(b).
[133] Treas Reg § 301.6722-1(b).

the executor, it may make more sense to provide the schedule A at the time the asset actually transfers to the beneficiary. Likewise, reporting information concerning assets that have not yet been received will tend to make it much more difficult for a beneficiary to determine the value of the assets the beneficiary later receives. Imagine the likely scenario of several hundred different stocks being listed on a Schedule A, only to have some sold prior to distribution, others purchased, and the beneficiary left to try to match everything up. Although these regulations may clearly fall within the interpretive authority of Treasury, it would seem that the practical impact of the regulations does not well serve the monitoring or the compliance purposes underlying the statute. In light of the fact that Congress mandates reporting be made to beneficiaries within 30 days of the estate tax return,[134] the content of that initial reporting instead should reflect the quality of the beneficiary's interest, but postpone details as to assets and value until such time as a distribution is made and title passes to the beneficiary. Reporting details only to those persons who hold title (and who consequently have the initial tax reporting duty for income tax purposes) would make the system much more effective and targeted to its ultimate purposes of consistency and monitoring.

[5] Subsequent Transfers Reporting by Recipient

Proposed regulations impose a subsequent transfers reporting requirement not specifically provided by statute. When the recipient distributes or transfers to certain transferees property that is or was required to be reported on Form 8971 or an accompanying Schedule A, the recipient is under a duty to report.[135] The statute squarely places the reporting burden on the person required to file the estate tax return.[136] Neither does the specific regulatory authority granted by Congress allow expansion of the reporting burden to persons other than the persons charged with filing the estate tax return. It does allow promulgation of 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." Fairly interpreted the reference would mean fair market value as of the date of death, which is the focus of Section 1014.[137] Neither the statute nor the grant of regulatory authority suggest that a continuing burden on persons other than the executor is appropriate.

Nevertheless the proposed regulations impose such a continuing burden on others. Specifically, the recipient's subsequent reporting requirement arises when the recipient (1) makes a transfer of property required to be reported on Form 8971 (including like-kind exchange or involuntary conversion property) in a manner such that the transferee's basis is determined in whole or in part by reference to the recipient's basis, and (2) the transferee is a "related transferee."[138] For example,

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[134] IRC § 6035(a)(3).
[135] Prop Treas Reg § 1.6035-1(f).
[136] IRC § 6035(a)(1) and (2).
[137] *See* ABA Section of Taxation Comments on Consistency in Basis Proposed Regulations (submitted June 20, 2016) , available at http://www.americanbar.org/groups/taxation/policy.html (last accessed June 28, 2016) (making similar suggestion as to focus on date of death value).
[138] Prop Treas Reg § 1.6035-1(f).

the recipient may have a reporting requirement if the recipient makes a gift or makes a distribution as a trustee to a related transferee.[139] There is no time limit on the reporting duty placed on the recipient, and it essentially continues until the recipient recognizes gain or loss, distributes to a non-related transferee or dies.

"Related transferee" is defined with reference to the definition of "member of transferor's family" pursuant to I.R.C. § 2704(c)(2), and includes any "controlled entity".[140] Member of transferor's family in relation to the "recipient-transferor" means transferor's spouse, transferor's and transferor's spouse's ancestors or lineal descendants, transferor's brother or sister, and the spouses of any of the ancestors, lineal descendants or brothers or sisters.[141] Controlled entity is defined as "a corporation or any other entity in which the transferor and members of the transferor's family..., whether directly or indirectly, have control."[142] Control means holding at least 50 percent by vote or value of a corporation's stock, holding at least a 50 percent capital or profits interest in a partnership, or holding of any general partnership interest in a limited partnership.[143] Comments submitted by the American Bar Association's Section of Taxation point out that related transferee is defined in terms of an individual, whereas the intent of the subsequent reporting requirement would seem that Treasury would also want the reporting burden to fall on a trustee of a trust making a subsequent distribution.[144]

To meet the recipient's reporting requirement, the regulations require the recipient to "file with the IRS a supplemental Statement and furnish a copy of the same supplemental Statement to the transferee."[145] The supplemental statement must be filed with the IRS and a copy furnished to the transferee no later than 30 days after the distribution or other transfer by the recipient.[146] The proposed regulations contemplate the necessity of filing by the recipient before the time the recipient receives a statement by the executor of decedent's estate. In that event the supplemental statement simply reports the change in ownership and does not report value information. If the recipient makes the transfer "before final value is determined," the recipient transferor must also provide the executor a copy of the supplemental statement.[147] This notifies the executor of the change in ownership, and places the burden on the executor to provide the statement or supplemental statement to the "new transferee" instead of to the recipient-transferor.

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[139] Prop Treas Reg § 1.6035-1(f).
[140] Prop Treas Reg § 1.6035-1(f). *See discussion,* Burke, J. Martin, Friel, Michael, Gagliardi, Elaine, Modern Estate Planning 2nd Ed., Ch. 69 (Lexis Publishing).
[141] *See* IRC § 2704(c)(2).
[142] Prop Treas Reg § 1.6035-1(f) (referencing IRC § 2701(b)(2)(A) or (B) to determine meaning of "control') .
[143] IRC § 2701(b)(2)(A) or (B).
[144] ABA Section of Taxation Comments on Consistency in Basis Proposed Regulations (submitted June 20, 2016), available at http://www.americanbar.org/groups/taxation/policy.html (last accessed June 28, 2016).
[145] Prop Treas Reg § 1.6035-1(f).
[146] Prop Treas Reg § 1.6035-1(f).
[147] Prop Treas Reg § 1.6035-1(f).

In justifying imposition of reporting requirements to beneficiaries not otherwise required to file an estate tax return, Treasury indicates:

> The purpose of this reporting is to enable the IRS to monitor whether the basis claimed by an owner of the property is properly based on the final value of that property for estate tax purposes. The Treasury Department and the IRS are concerned, however, that opportunities may exist in some circumstances for the recipient of such reporting to circumvent the purpose of the statute (for example, by making a gift of the property to a complex trust for the benefit of the transferor's family).

Treasury underwrites its authority by referencing as a justification for the imposition of a reporting requirement on certain beneficiaries "the regulatory authority granted in section 6035(b)(2)."[148] The reference is perplexing as that sub-section of the Code addresses situations where "joint tenant[s] or other recipient[s]" have "better information than the executor regarding basis or fair market value."[149] The proposed regulations extending reporting requirements obtain better information as to "identity" of the ultimate owner of property; those regulations do not focus on obtaining better information as to basis or value. In fact the preamble to the proposed regulations contradicts this reliance by Treasury when it acknowledges that Treasury does not issue any regulations pursuant to I.R.C. § 6035(b)(2).[150] Neither does the grant of authority to promulgate regulations relating to: "the application of this section to property … to which no estate tax return is required to be filed"[151] seem to apply because extension of the reporting regulations to recipients of "reported property" does not fall within its terms. The extension of the reporting requirement to recipients of reported property "back doors" its way to a reporting requirement for donors that was seemingly rejected by Congress when it declined to adopt the reporting requirement for "donors" as was set forth in the Obama proposal.

The subsequent transfers reporting requirement also proves troubling in its lack of clarity and practical import. The policy underlying the extension is to preclude the making of a gift to a complex trust, yet its reach is much broader. In addition, practically, the reporting requirement should extend until such time as a section other than I.R.C. Section 1014 determines basis. Treasury recognizes that the reporting requirement should terminate at the time a transaction causes recognition of gain or loss. Yet, Treasury asserts that reporting should continue in other situations where I.R.C. Section 1014 ceases to be the operative section determining basis. With respect to a like-kind exchange, basis is determined pursuant to I.R.C. Section 1031(d) and may no longer equal basis under I.R.C. Section 1014. To continue to provide a beneficiary with Section 1014 basis when another statute controls determination of basis will likely prove utterly confusing and imply to a beneficiary receiving the statement that the rules of Section 1031(d) no longer apply. The same

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[148] 2016-12 IRB 473 (Preamble to proposed regulations, paragraph 13).
[149] IRC § 6035(b)(2).
[150] 2016-12 IRB 473 (Preamble to proposed regulations, paragraph 14).
[151] IRC § 6035(b)(1).

analysis could be made with regard to gifts[152] and involuntary conversions.[153] At the point that basis ceases to be determined solely by the rules of I.R.C. Section 1014, reporting should cease, rather than force provision of date of death fair market value and incorrectly imply that value is determinative of basis following a gift, like-kind exchange or involuntary conversion. In the event Treasury continues the subsequent transfer reporting requirement in the final regulations, it would be critical to reconfigure the Schedule A to explain determination of basis per Sections 1015, 1031 and 1033, or any other sections that may be applicable.

[6] Reporting Due Dates

Filing of Form 8971 and accompanying Schedules A must be made no later than the earlier of (i) the date which is 30 days after the due date of the estate tax return, including extensions and (ii) the date that is 30 days after the estate tax return is filed.[154] At the same time that the Form 8971 must be filed, each beneficiary of property reported on Form 8971 must receive a Schedule A.

The basis consistency reporting regulations similarly contemplate filing supplemental Forms 8971 and supplemental Schedules A within 30 days of the event triggering the supplemental reporting. Specifically, the due date for an executor to file a supplemental return is, with one important exception, the date 30 days after (a) determination of final value, (b) discovery of information that must be reported by supplemental filing, or (c) filing of a supplemental estate tax return reporting property not previously reported.[155] The exception will prove to be a welcomed one and recognizes that it is at the time of distribution that the beneficiary needs to receive the information indicating the Section 1014 basis. The exception to the general rule applies to property in a probate estate or held by a revocable trust at decedent's death if the event triggering the supplemental reporting occurs after decedent's death but prior to or as of distribution of property to the beneficiary.[156] In that event the due date of the supplemental information return and statements is the date 30 days after the date of distribution to the beneficiary.[157]

To meet the recipient's reporting requirement on certain types of subsequent transfers, proposed regulations likewise require the recipient to "file with the IRS a supplemental Statement and furnish a copy of the same supplemental Statement to the transferee" within 30 days of the triggering event. The supplemental Statement must be filed with the IRS and a copy furnished to the transferee no later than 30 days after the distribution or other transfer by the recipient to which the reporting duty applies.[158]

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[152] IRC § 1015 (sets forth basis of gifts).
[153] IRC § 1033(b) (sets forth basis on involuntary conversions).
[154] Prop Treas Reg § 1.1045-1(d).
[155] Prop Treas Reg § 1.6035-1(e)(4)(i).
[156] Prop Treas Reg § 1.6035-1(e)(4)(ii).
[157] *Id*.
[158] Prop Treas Reg § 1.6035-1(f).

Failure to timely file results in penalties generally imposed for late or incorrect filing of informational returns.[159] Neither the statutory provisions not the proposed regulations fully address the difficulties in obtaining information from beneficiaries. It is hoped that proposed regulations will recognize and make allowances for these practicalities. Commentators have suggested allowing the filer to indicate certain identifying information is unknown, and have also suggested allowing a request for extension to file.[160] Without some accommodation, no matter the extent of the efforts taken by an executor who has every intention of complying with the reporting requirement, the executor may suffer imposition of penalties.

§ 1.06 Conclusion

With new found planning emphasis on obtaining I.R.C. Section 1014 basis, it is not surprising that Congress felt impelled to impose consistent basis reporting requirements. The statutory provisions as enacted, however, prove much narrower than that argued for in President Obama's budget. Nevertheless Treasury has chosen to issue regulations interpreting the enactment more broadly than necessary to achieve the statute's underlying purpose of ensuring an income tax basis consistent with the value reported on the estate tax return. The broad interpretation by Treasury will unnecessarily create confusion for beneficiaries and likely make it more difficult for beneficiaries to accurately determine basis. As issued, the proposed regulations needlessly extend the reporting burden imposed by Congress and, in doing so, will cause sufficient confusion among recipients of decedent's property to require recipients to seek the advice of a tax professional.

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[159] *See* Prop Treas Reg § 1.6035-1(h).

[160] *See* American Institute of CPAs Comments on Proposed Rules on Consistent Basis Reporting Between Estates and Beneficiaries (submitted June 1, 2016), available at https://www.aicpa.org/InterestAreas/PersonalFinancialPlanning/CPEAndEvents/Pages/Estate-Basis-Consistency.aspx (last accessed June 24, 2016).