

Tax Law: Highway Bill Imposes New Basis Consistency and Reporting Requirements

By: **Megan C. Neal**

Editor's note: This article is updated from the version that appeared in print to reflect an IRS deadline extension to March 31, 2016.

On July 15, 2015, President Barack Obama signed the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, commonly known as the Highway Bill.

The Highway Bill imposes new requirements on some executors and beneficiaries. In general, beneficiaries are now required to use the finally determined federal estate tax value as their basis when reporting gain or loss on the sale or exchange of (or depreciation/amortization on) the assets received from a decedent on the beneficiary's federal income tax return (the "basis consistency rules").

Certain executors are now required to notify the IRS and beneficiaries of the finally determined federal estate tax value of the property to be received from the decedent (the "basis information reporting requirements").

Basis Consistency Rules

Section 2004(d) of the Highway Bill amends Section 1014 of the Internal Revenue Code of 1986, as amended, by adding a new subsection (f). Under Section 1014(f), a beneficiary's basis in any property acquired from a decedent must not be greater than the value finally determined for federal estate tax purposes. The finally determined value will be the value the executor reports on the decedent's federal estate tax return, Form 706, if the IRS fails to audit the return within the statute of limitations.

However, if the IRS audits the return, and the audit value is not contested by the executor before the statute of limitations has run, the finally determined value is the value stated by the IRS. If the value is litigated by the IRS, the finally determined value is the value determined by the court or under a settlement agreement with the IRS.

If there is no finally determined value, the beneficiary's basis in any property acquired from a decedent is the value provided in Schedule A to Form 8971 that the executor now must provide to the beneficiary and the IRS under Code Section 6035(a) (discussed below). Because Section 6035(a) requires the executor to send such form/schedule(s) before the estate tax value is finally determined, the beneficiary's basis, in most cases, will be the value contained in Schedule A, at least initially.

When Is Basis Consistency Required?

The basis consistency rules apply only to a beneficiary that receives property whose inclusion in the decedent's estate increased the estate tax liability with respect to a Form 706 filed after July 31, 2015 (whether timely filed or late). If no Form 706 is required to be filed because the gross estate plus the adjusted taxable gifts is less than the basic exclusion amount, but a Form 706 is filed solely to elect portability, then the basis consistency rules do not apply.

Property qualifying for the marital or charitable deduction does not contribute to an increase in the estate tax, so the beneficiary receiving such property is exempt from the basis consistency rules.

Penalty for Inconsistent Basis Reporting

The Highway Bill amended Code Section 6662, which imposes an accuracy-related penalty on certain underpayments of tax, to add "inconsistent estate basis" as a grounds to impose this penalty. Under Code Section 6662(k), there is inconsistent estate basis if the basis of the property claimed on a return exceeds the basis as determined under Code Section 1014(f). If a beneficiary subject to the basis consistency rules claims a basis on his

or her income tax return in excess of the basis determined under Code Section 1014(f), a 20 percent penalty on the underpayment of tax attributable to inconsistent estate basis will apply.

Statute of Limitations

The Highway Bill also amended Code Section 6501 to provide that an overstatement of basis is treated as an omission of gross income. Except as provided in Code Section 6501(c), if basis is overstated, the six-year statute of limitations applies when gross income is understated by more than 25 percent.

Basis Information Reporting Requirements

In general, Section 2004 of the Highway Bill added a new Code Section 6035. Under Section 6035(a), the executor of any estate (or other person) that is required to file a Form 706 must provide a statement to the IRS and each beneficiary receiving any property that is included in the decedent's gross estate identifying the value of property reported on Form 706.

To report such values, submit: (i) Form 8971 and Schedule(s) A to the IRS separately from the estate tax return, and (ii) provide each beneficiary (including an executor who is a beneficiary) with a copy of only that beneficiary's Schedule A either in person, by email or mail to the beneficiary's last known address. If it cannot yet be determined which beneficiary will receive which assets, list all property that could be used to fund that beneficiary's distribution on that beneficiary's Schedule A and file a supplementary form/schedule once the distributions are made. Form 8971 and its instructions are available at irs.gov/pub/irs-pdf/f8971.pdf and irs.gov/pub/irs-pdf/i8971.pdf.

The deadline for sending the Form 8971 and Schedule(s) A is no later than the earlier of: (i) 30 days after the date Form 706 was required to be filed (including extensions), or (ii) 30 days after the date Form 706 was filed. However, in Notice 2016-19, the IRS extended this deadline to March 31, 2016, for otherwise earlier-due statements. If the information reported on Form 8971 and Schedule(s) A differ from the final estate tax value, the executor (or other person who was required to file a Form 706) has 30 days from the adjustment to file a supplemental Form 8971 and affected Schedule(s) A with the IRS and Schedule A to each affected beneficiary.

When Is a Basis Information Report Required?

Form 8971/Schedule(s) A must be filed with the IRS and Schedule A must be provided to the beneficiary listed on such Schedule if the executor (or other person) who is required to file a Form 706 files Form 706 after July 31, 2015.

If a beneficiary is not subject to the basis consistency rules, the executor still may be obligated to file Form 8971. If the executor files Form 706 solely to elect portability, the executor must file Form 8971/Schedule(s) A with the IRS and the beneficiaries, even though the beneficiaries are not subject to the basis consistency rules.

Penalties

Under the Highway Bill, Code Section 6724(d) was amended to add Form 8971/Schedule(s) A to the definition of "informational return." Under Code Section 6721, a penalty may be imposed for failing to timely file or provide all the required information or for providing incorrect information on an initial or supplemental Form 8971/Schedule(s) A. Under the form's instructions, one penalty applies for failures relating to a single filing, but each filing of Form 8971/Schedule(s) A (initial or supplemental) is a separate filing.

Uncertainty, Inconsistencies and Anticipated Regulations

Guidance is still needed to address the uncertainties surrounding the new basis consistency rules and basis information reporting requirements. These new rules are also inconsistent with established law in at least two instances. Specifically, under established law, basis in the following property received at death may exceed the finally determined estate tax value: (1) partnership or LLC interests owned by a decedent when the entity has debt, and (2) the value of real property owned by a decedent when that property is subject to non-recourse debt. The secretary of the US Treasury might issue regulations to address the uncertainties and create exceptions to rectify these inconsistencies. With any luck, they will do so prior to March 31, 2016.

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