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## **Estate Basis Consistency Rules for Fiduciaries: Navigating Reporting Requirements and Distribution Strategies**

Avoiding Penalties, Determining Impact of Disclosure Rules on Estate  
and Beneficiaries, and Making Post-Mortem Basis Adjustments

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TUESDAY, MARCH 5, 2019

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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Today's faculty features:

Carolina Nuche, Attorney, **Baker McKenzie**, Miami

Rodney W. Read, Partner, **Baker McKenzie**, Houston

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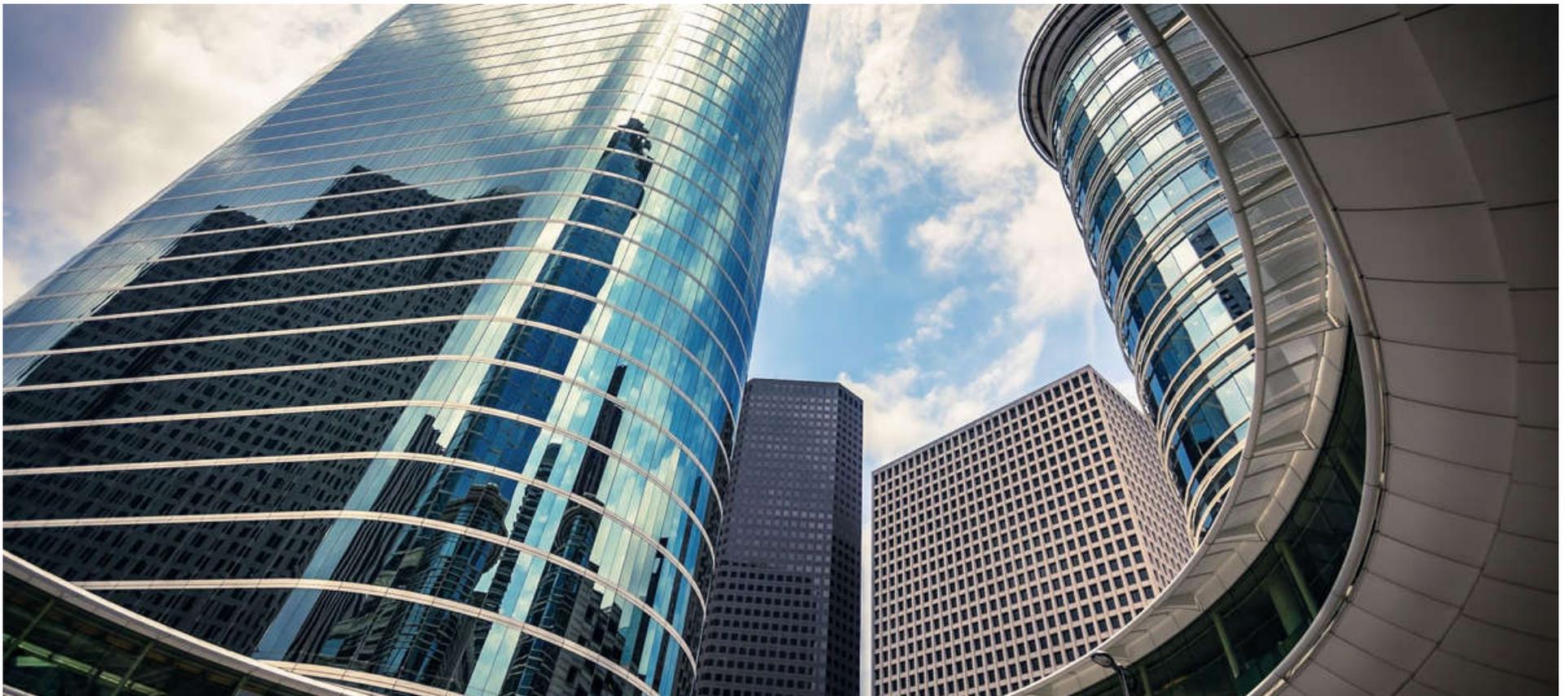
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## Estate Basis Consistency Rules for Fiduciaries: Navigating Reporting Requirements and Distribution Strategies

Presenters: Rodney Read & Carolina Nuche

March 5, 2019



# Topics Overview

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- **Background**
- **Section 1014 basis consistency rules**
  - Estates subject to basis consistency
  - Property subject to basis rule
  - Final value determination methods
  - Zero basis rule and other tax consequences due to omission or nonreporting
- **Section 6035 reporting requirements**
- **Supplemental reporting requirements**
- **Impact of new rules on beneficiaries**
- **Distribution considerations and strategies**

# Background

# Background

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- **Surface Transportation and Veterans Health Care Choice Improvement Act of 2015**
  - passed July 31, 2015
- **Problem = No way for the IRS to track/match value of property as reported by an estate for estate tax purposes with the basis used by the recipients of that property**
  - perceived abuse
- **Solution = REPORTING!!!!**

# Background

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- Proposed Regulations issued in March 2016
  - not yet final
- These rules apply to estate tax returns filed after July 31, 2015
  - applicable to decedent who died prior to July 31, 2015 if has not filed estate tax return before that date

# Basis Consistency Rules

# Which Estates Subject to Basis Consistency?

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- Estates with a federal tax liability
  - after application of credits
- No estate tax = not subject to the basis consistency rules

# What Property Subject to Basis Rule?

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- Generally, the entire gross estate
  - because all the property contributed to the estate tax liability
- Property included in the gross estate under §2031
- Property subject to tax under §2106
- Other property the basis of which is determined in whole or in part by reference to the basis of such property (i.e., like-kind exchange or involuntary conversion) that generates an estate tax liability.

# What Property Subject to Basis Rule?

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- Exclusions
- Property that qualifies for charitable or marital deduction
  - does not generate an estate tax liability
- Tangible personal property for which an appraisal is not required
  - generally, tangible personal property with a value less than \$3,000



# Final Value Determination Methods

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- **The property's value as shown on a filed estate tax return**
  - and the IRS does not timely adjust or contest that value
- **If not the above, the value as determined by the IRS**
  - when the periods for assessment and refund or credit have expired without the value having been contested
- **If neither of the above, the value determined in an agreement**
  - that is final and binding on all parties
- **If none of the above, the value as has been determined by a court**
  - and that determination is final.

# Subsequent Basis Adjustment

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- Post death events may adjust basis (as permitted under other parts of the Code)
  - gain recognized on an in-kind distribution of property from the estate or trust
  - post-death capital improvements to the property
  - depreciation or amortization
  - post-death adjustments to the basis of an interest in a partnership or S corporation



# Omissions and Nonreporting

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- Estate tax return filed and after-discovered or omitted property found
- Prior to expiration of limitation on assessment
  - no penalty if file an initial or supplemental estate tax return reporting the property
- No reporting prior to expiration of limitation on assessment
  - zero basis for all unreported property
- No estate tax return filed
  - zero basis for all property (until estate tax return is filed)



# Reporting Requirements

## §6035 Reporting – Form 8971 and Schedule A

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- Executor required to file Form 8971 with attached Schedule(s) A with the IRS
- Executor required to provide each beneficiary listed on the Form 8971 with that beneficiary's Schedule A

## §6035 Reporting – Form 8971 and Schedule A

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- **Form 8971 not required**
  - if no estate tax return is required
  - the estate tax return is filed solely to make an allocation or election respecting the GST tax
  - the estate tax return is filed solely to elect portability
  - if estate tax return is filed as a protective filing to avoid penalties in the event of changes in asset values.

## §6035 Reporting – Form 8971 and Schedule A

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- Reports the final value of all property included in gross estate
  - property the basis of which is determined in whole or in part by reference to the basis of such property (i.e., like-kind exchange or involuntary conversion)
  - property – for a deceased nonresident noncitizen – that is subject to estate tax
  - decedent's one-half of community property



## §6035 Reporting – Form 8971 and Schedule A

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- **Property excepted from reporting**
  - cash
  - IRD
  - tangible personal property with value less than \$3000 (for which an appraisal is not required)
  - property that is sold or otherwise disposed of by the estate in a transaction in which capital gain or loss is recognized

## §6035 Reporting – Form 8971 and Schedule A

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- **Identification of beneficiaries**
  - life tenant (beneficiary of a life estate)
  - remainderman (beneficiary of a remainder interest) identified as if the life tenant were to die immediately after the decedent
  - beneficiary of a contingent interest, unless the contingency has occurred prior to filing
    - if the contingency subsequently negates the inheritance of the beneficiary, the executor must file supplemental reporting (discussed later)

## §6035 Reporting – Form 8971 and Schedule A

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- If not finally determined who will receive what property by the time of filing the executor must report on each beneficiary's statement all property that the executor could use to satisfy the interest of that beneficiary
- This duplicate reporting cause any issues?
  - unwanted disclosure
  - fighting among beneficiaries

## §6035 Reporting – Form 8971 and Schedule A

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- Unknown beneficiary - executor must use reasonable due diligence to identify and locate
- If unable, must explain efforts on Form 8971 that the executor took to locate the beneficiary and to satisfy the obligation of reasonable due diligence
- If subsequently locates the beneficiary, within 30 days of locating the beneficiary the executor must furnish the beneficiary with that beneficiary's Schedule A statement and file a supplemental Form 8971

## §6035 Reporting – Form 8971 and Schedule A

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- Required to file Form 8971 and furnish each beneficiary with their Schedule A statement 30 days after the earlier of:
  - the deadline for filing the federal estate tax return, or
  - the date the return is actually filed

# §6035 Reporting – Form 8971 and Schedule A

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- **Penalties**
  - failure to file correct Form 8971 or furnish Schedule A to beneficiaries by the due date
  - the amount of the penalty depends on when the correct form is filed or furnished
  - \$50 per form if filed within 30 days after due date (up to \$532,000 per year)
  - \$260 per form if filed after 30 days or is not filed (up to \$3,193,000 per year)
  - if due to intentional disregard then at least \$530 per form with no maximum
  - may be able to qualify for lower maximum penalties



# Supplemental Reporting

# Supplemental Reporting Requirements

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- If a change is needed to the information reported on Form 8971 or Schedule A the executor is required to file a supplemental Form 8971 including supplemental Schedule A
- Also required to furnish corresponding supplemental Schedule A statements to affected beneficiary

# Supplemental Reporting Requirements

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- **Examples of adjustments requiring supplement**
  - discovery of property that should have been reported
  - change in the property value pursuant to an examination or litigation
  - change in the identity of the beneficiary to whom the property is to be distributed
  - executor's disposition of property acquired from the decedent or as a result of the death of the decedent in a transaction, such as a like-kind exchange or involuntary conversion, in which the basis of new property is determined in whole or in part by reference to the disposed property



# Supplemental Reporting Requirements

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- Examples of adjustments not requiring supplement (but the executor may file)
  - to correct an inconsequential error or omission
  - to specify the actual distribution of assets that were duplicate reported

# Supplemental Reporting Requirements

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- Supplement reports are due on or before 30 days after
  - the final value of property is determined
  - the executor discovers error or incomplete form
  - a supplemental US federal estate tax return is filed to report property not reported on a return filed previously

# Impact on Beneficiaries

# Impact on Beneficiaries

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- Subsequent transfers to a related transferee by a recipient of property who receives a Schedule A statement may have a reporting obligation
- If transferred in a transaction in which the related transferee's basis is determined in whole or part with reference to the transferor's basis (e.g., gift transactions and like-kind exchanges)
- Transferor is required to provide the IRS and the related transferee a supplemental statement documenting the new ownership within 30 days after the date of transfer



# Impact on Beneficiaries

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- **Related transferee**
  - spouse, ancestor or descendant of such individual or of their spouse, siblings of the individual, and spouses of the siblings, spouses of the ancestors of the individual or of the ancestors of their spouse, spouses of the descendants of the individual or of the descendants of their spouse, controlled entities, and any trust which is deemed owned by the transferor

# Impact on Beneficiaries

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- Reporting requirement imposed on each transferee in the chain of property ownership
- If subsequent transfer made before a final value of the asset is determined, must provide the executor with a copy of the supplemental Schedule A statement reporting the new ownership of the property
- Upon the final value being determined, the executor will provide a supplemental Schedule A statement to the new transferee

# Impact on Beneficiaries

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- Sale of property, file and pay tax on gain, all before final value
- If receive supplemental Schedule A, must amend (if possible?)
- How does beneficiary disagree with value given on Schedule A?

# Distribution Considerations

# Distribution Considerations and Strategies

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- **Obtain information from beneficiaries early**
  - errors relating to a TIN or beneficiary's surname are never inconsequential and will be subject to penalty
- **Keep track of all beneficiaries**
  - may need to send supplemental Schedule A in the future
- **Fiduciary has ongoing obligation until all values are final**
  - may extend beyond the closing of the estate



# Distribution Considerations and Strategies

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- **Successor trustee**
  - ask which assets are subject to a Schedule A
  - which values are final?
  - proactively notify executor



Rodney Read

[rodney.read@bakermckenzie.com](mailto:rodney.read@bakermckenzie.com)

Carolina Nuche

[carolina.nuche@bakermckenzie.com](mailto:carolina.nuche@bakermckenzie.com)

[www.bakermckenzie.com](http://www.bakermckenzie.com)

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