

New Federal Tax Legislation Impacts Executors AND Beneficiaries

Description

This summer, new federal legislation was enacted which requires executors of decedents' estates to file information statements with the Internal Revenue Service ("IRS") as well as with estate beneficiaries, or face penalties. This new legislation also dictates how beneficiaries will establish cost basis for property inherited from a decedent. New Internal Revenue Code ("IRC") Sections 1014(f) and 6035 were added to the tax statute in July 2015 to address cost basis reporting, which took effect immediately, applying to all estates filing federal estate tax returns after July 31, 2015. The new legislation does not, as one might otherwise expect, focus on the date of death of the decedent, but instead sets a deadline of compliance for returns filed after July 31, 2015 regardless of the date of death of the decedent. (Yes, this could result in "retroactive" penalties!) Importantly, the legislation does not apply to estates filing federal estate tax returns for the sole purpose of electing portability.

The statute requires executors to provide the IRS and estate beneficiaries with the value of the estate assets as finally determined and reported on federal estate tax returns filed after July 31, 2015. The beneficiaries are required to use those asset values as the cost basis of the assets inherited from the decedent and will no longer be able to claim that the fair market value of an asset on the date of death was actually greater than the value used for estate tax purposes.

Historically, although the value of an asset as finally determined for federal estate tax purposes has been accepted as evidence of true fair market value, beneficiaries have been permitted to attempt to prove that the value was actually higher, thereby providing the beneficiary with a higher cost basis and a smaller income tax bill upon sale of the inherited asset. New Section 1014(f) was intended to close this so-called "loophole" by denying beneficiaries the opportunity to establish a higher basis than that reported on the decedent's federal estate tax return. Notably, new Section 1014(f) only applies if the assets in question triggered an increase in the estate tax liability; if the estate paid no estate tax, perhaps due to the marital deduction, new Section 1014(f) does not seem to apply.

However, new Section 6035 applies for all executors regardless of whether the asset in question triggers an increase in the federal estate tax liability. The executor of the estate may face penalties for failure to file the newly required information statements *by the due date of the return*. If a decedent's estate is required to file a federal estate tax return pursuant to IRC Section 6018(a), then new Section 6035 requires the executor to provide detailed valuation information to both the beneficiaries of the estate and the IRS. Until and unless clarifying regulations are promulgated, this new Code section appears to require executors to provide this valuation information to a broad class of beneficiaries – all present as well as future trust beneficiaries where the decedent's assets are held in the name of the decedent's revocable living trust and/or are distributed to trusts after death.

The valuation statements are due no later than 30 days after the due date for filing the federal estate tax return, including extensions, or, if the return is filed earlier than its due date, within 30 days of the date the return is

actually filed. Should adjustments be made to asset values thereafter, perhaps upon audit, then the executor is required to provide a supplemental statement within 30 days after the date of the adjustment.

What are the penalties imposed on the executor who fails to comply with the new law? A penalty of \$250 per occurrence is assessed beginning January 1, 2016, while a penalty of \$100 per occurrence applies for federal estate tax returns filed in 2015. The maximum penalty for all such failures to file in any given calendar year beginning in 2016 is \$3,000,000, while the maximum penalty for all failures to file in 2015 is \$1,500,000. For executors who intentionally disregard the new law, penalties are generally double and can equate to 10 percent of the aggregate amount of the items required to be reported correctly (see Code Sections 6721(e) and 6722(e)). As one might expect, a waiver is provided if the executor's failure to file was due to "reasonable cause".

Not unexpectedly, the new legislation raises many questions and presents some dilemmas. What if an executor, despite reasonable effort and diligence, does not know exactly which assets will be distributed to certain beneficiaries within 30 days of filing the federal estate tax return? This is not an unusual circumstance in estate administration. Does the new legislation require the executor to provide all beneficiaries of the estate with valuation information statements for all estate assets? Even assets which the beneficiary does not ultimately receive? And even when the decedent may have set up different trusts for different beneficiaries for privacy purposes? What havoc could that raise among beneficiaries? How disrespectful to a decedent's last wishes.

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