Probate & Trust Section, Tax Committee
Tax Updates – October 2015
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<u>GUIDANCE FROM THE IRS</u>

Rev Rul 2015-21, 2015-40 IRB (October 5, 2015), October 2015 Rates:

- Section 7520 Rate: 2.0%
- Annual Short Term AFR (0-3 years): .55%
- Annual Mid Term AFR (3-9 years): 1.67%
- Annual Long Term AFR (over 9 years): 2.58%

The IRS has posted the final Instructions for Form 706 for 2015 decedents. It is speculated that the IRS will not be releasing a revised Form 706 at this time but will continue to use the August 2013 form.

The IRS has not issued a release of Form 709 for 2015. Draft Instructions for Form 709 were posted on September 28, 2015.

Legal Advice Issued by Field Attorneys 20152201F The IRS has concluded that a taxpayer failed to disclose gifts to his daughter in a manner adequate to apprise IRS of the nature and amount of the gifts (of partnership interests). Specifically, the donor failed to sufficiently identify one of the gifts and to adequately describe the method used to determine the fair market values of the gifts. As a result, the period of limitations for the gift tax was held open indefinitely under Code Sec. 6501(c)(9).

The Internal Revenue Code imposes a tax on a transfer of property by gift. (Code Sec. 2501(a)). An individual who makes a transfer by gift in any calendar year must file a gift tax return for that year using Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return. (Code Sec. 6019, Reg. § 25.6019-1(a)).

Absent an exception, IRS must assess the amount of any gift tax within three years after Form 709 is filed. (Code Sec. 6501(a)). However, for a gift that is required to be "shown" on a Form 709, but which is not shown, the gift tax may be assessed at any time. (Code Sec. 6501(c)(9)). In other words if the gift is not "shown" on the return, the limitation period doesn't start running.

A transfer will be considered adequately disclosed (shown) to the IRS if the following information is provided:

- A description of the transferred property and any consideration received by the transferor;
- The identity of, and relationship between, the transferor and each transferee;
- If the property is transferred in trust, the trust's tax identification number and a brief description of the terms of the trust, or in lieu of a brief description of the trust terms, a copy of the complete trust instrument;
- A detailed description of the method used to determine the fair market value of property transferred, including any financial data (for example, balance sheets, etc. with explanations of any adjustments) that were utilized in determining the value of the interest, any restrictions on the transferred property that were considered in determining the fair market value of the property, and a description of any discounts, such as discounts for blockage, minority or

fractional interests, and lack of marketability, claimed in valuing the property. (Alternately, a donor can provide an appraisal in lieu of this information (Reg. § 301.6501(c)-1(f)(3)); and

- A statement describing any position taken that is contrary to any proposed, temporary, or final Treasury regs or revenue rulings published at the time of the transfer. (Reg. § 301.6501(c)-1(f)(2)).

Additionally, in the case of a gift of a closlely held asset, the description on the 709 must include discounts claimed in valuing the interests in the entity or any assets owned by such entity and if the value of the entity is properly determined based on the net value of its assets, the return must include a statement regarding the value of 100% of the entity. (Reg. § 301.6501(c)-1(f)(2)(iv)).

In the matter in question, the taxpayer missed a digit of the EIN for one of the entities transferred, did not give adequate description of the discounts applied or the mechanism for applying such discounts and did not provide adequate valuation information for the underlying assets of the entities gifted.

RECENT COURT GUIDANCE

(Jean Steinberg, Donor, (2015) 145 TC No. 7) The Tax Court concluded that the fair market value of a taxpayer's gift to her daughters should be reduced by the daughters' assumption of potential Code Sec. 2035 liability.

The taxpayer entered into a net gift agreement with the donees. The taxpayer transferred cash and securities to the donees. In exchange, the donees agreed that they would pay any federal gift tax liability and/or pay any federal or state estate tax imposed as a result of the gifts to them being included in the taxpayer's gross estate if she died within three years of the gifts. The net gift agreement was the result of arm's-length negotiations, with the taxpayer and donees represented by separate counsel.

Using the willing buyer-willing seller theory of valuation, the Tax Court concluded that the donees' assumption of the estate tax liability should be considered and should reduce the fair market value of the gift since it was a detriment to the donees and a benefit to the taxpayer. Analogizing the assumption of the potential estate tax liability to the reduction of stock value due to built-in capital gains, the assumption of the liability was a detriment to the donees because it might reduce the value of the gifts received from the taxpayer if she died within three years of the gifts. The assumption of the estate tax liability relieved the taxpayer's estate of potential estate tax liability and was reducible to a monetary value.

The IRS argued that the state (New York) apportionment law, would have required the donees to pay ratable shares of the tax incurred under Code Sec. 2035(b), rendered the net gift agreement duplicative or illusionary but the Tax Court rejected such argument because there was no guarantee that the donees would remain beneficiaries of the will or that New York law would apply at the time of her death.

Because there was a detriment to the donees and a benefit to the donors and the net gift agreement was *bona fide*, the value of the gift was reducible by the assumption of the estate tax liability.