goulston&storrs

New Basis Reporting Requirements for Executors and Beneficiaries

March 30, 2016

Recent federal legislation adds fresh compliance burdens to an old concept in federal tax law: the step-up in tax basis of appreciated property at death. New reporting requirements will apply to estates required to file a federal estate tax return after July 31, 2015 and are effective beginning June 30, 2016. Executors and beneficiaries who do not comply with the new rules may be subject to penalties.

When a person sells an asset that has appreciated in value, the gain recognized generally equals the sale price minus the seller's "tax basis" in the property, usually the amount paid to acquire the asset. When a person dies owning appreciated property, the property generally acquires a new tax basis equal to its fair market value as of the date of death. This "step-up" in basis has the effect of wiping out the income tax burden on all pre-death appreciation in the property. (Property can also depreciate in value and receive a "step-down" in basis at the decedent's death.)

In the past, a beneficiary of an estate would often look to a federal estate tax return for information about the fair market value (and hence the new tax basis) of an inherited asset, and under the new legislation this common practice will generally be required.

The new tax basis consistency requirements were added as part of the Surface Transportation and Veterans Health Care Improvement Act of 2015. They seek to raise revenue by enforcing consistency between the new tax basis of an asset as reported for estate tax purposes and the tax basis reported by the beneficiary when the asset is later sold or depreciated. This is accomplished by imposing new reporting obligations on both executors and beneficiaries.

Executors' Reporting Requirements

If an estate is required to file a federal estate tax return, the executor is required to report valuation information to both beneficiaries and to the IRS. The report is made on the new IRS Form 8971. The executor is required to list the names of all of the beneficiaries receiving property from an estate, their addresses and their taxpayer identification numbers. The executor also is required to identify on Schedule A to Form 8971 each item of property passing to a beneficiary and its estate tax value. There is a separate Schedule A for each beneficiary. If a beneficiary is a trust, the executor may furnish this information to the trustee rather than to each underlying beneficiary of the trust. If the executor has not determined what property will pass to each particular beneficiary by the time Form 8971 is due (which may be the case if a beneficiary is to receive a share of the decedent's estate, but the particular items have not yet been selected), the executor must report on the statement for each beneficiary all of the property that the executor could use to satisfy the beneficiary's interest.

Certain types of property are exempt from the reporting requirements. These include cash, retirement accounts, items of tangible personal property valued at less than $3,000, and property sold by the estate in a taxable sale before being distributed to a beneficiary. Thus, an estate that is wholly liquidated prior to dissolution should be free of this reporting requirement.

The new reporting requirement applies only to estates in which the value of the assets, plus the value of lifetime gifts made by the decedent, exceed $5,450,000 in 2016 (or $5,430,000 for 2015 estates). The tax basis reporting requirement does not apply to estates that file a federal estate tax return only to make a "portability" election.

Form 8971 must be filed either 30 days after the date on which an estate's federal estate tax return is due or is actually filed, whichever comes first. In order to give executors more time to comply with the new rules, the IRS extended to June 30, 2016 the due date for any information returns that would have been due before that date.

Penalties for failure to file Form 8971 with the IRS generally range from $50 to $260 per Form 8971, with higher amounts due in the case of intentional disregard of the filing requirements. The same penalties apply in the case of an executor who fails to provide a beneficiary with an accurate Schedule A.

Beneficiaries' Obligations

The new legislation provides that the tax basis of property acquired by a beneficiary from a decedent cannot exceed the federal estate tax value. A beneficiary is therefore required to use the tax basis reported on Schedule A to Form 8971 when later selling or depreciating the property. This could be problematic if, for some reason, the beneficiary does not agree with the executor's valuation. New IRS Regulations make clear that property that qualified for a marital deduction or a charitable deduction is not subject to this new basis consistency rule.

A beneficiary who uses a basis that is inconsistent with the amount shown on Schedule A may be liable for a 20% accuracy related penalty for any understated taxes.

The basis reporting requirements are new and evolving and present challenges to executors and beneficiaries of large estates. For questions about the information in this advisory, please contact your Goulston & Storrs attorney or any member of the Private Client & Trust or Tax Groups.

This advisory should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general informational purposes only, and you are urged to consult your own lawyer concerning your situation and any specific legal questions you may have.