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Setting Income Tax Basis at Death (and the new Reporting Rules)

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Although some have argued strongly to the contrary, it was clear for decades even before the statute was amended in 1978 that the income tax basis of property in the hands of those acquiring property passing from a decedent was – (1) the fair market value of the property at the date of the decedents’ death; the value established by alternate valuation; or the value derived from special use valuation. Those provisions have not allowed the setting of income tax basis for property acquired from a decedent to wait months if not years before committing to the new income tax basis figure for property acquired earlier from a decedent.

Some of those arguing to the contrary have voiced opposition to the 2015 move to require reporting of income tax basis information to the Internal Revenue Service and to all of those acquiring any interest in property from the decedent if a Form 706 is required to be filed. The “Surface Transportation and Veterans Health Care Choice Improvement Act of 2015,” signed on July 15, 2015, contains Section 2004 which amends I.R.C. § 1014 of the Internal Revenue Code by adding subparagraph (f) which states that “basis must be consistent with the federal estate tax return.” The statute goes on to state that, for property acquired from a decedent, the income tax basis may not exceed the value determined for federal estate tax purposes. The statute then cautions that this new rule only applies “... to any property whose inclusion in the decedent’s estate increased the liability for the tax imposed for federal estate tax purposes, reduced by credits allowable against the tax.”

This effectively limits the provision to higher tax bracket taxpayers.

Importance of how basis is determined

The statute states that the income tax basis can be determined in three possible ways – (1) if the value is shown on a federal estate tax return and is not contested before the expiration of the time for assessing a federal estate tax; (2) the value is specified by the Secretary of the Treasury and is not contested in a timely manner by the executor of the estate; or (3) the value is determined by a court or pursuant to a settlement with the Secretary of the Treasury.

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Information reporting required

Under the statute, the executor of any estate required to file a federal estate tax return\(^a\) must furnish to the Department of the Treasury (presumably IRS), and to each person acquiring any interest in property included in the decedent’s gross estate, a statement identifying the value of each interest in that property as reported on the federal estate tax return.

Moreover, any person required to file a return under I.R.C. § 6018(b) (which pertains to situations where the executor of an estate is unable to make a complete federal estate tax return as to any part of the gross estate of the decedent and is required to include in the return a description of the property involved and the name of every person holding a legal or beneficial interest in the property), must include the same information referred to in the preceding paragraph.\(^b\)

The time for filing those statements is not later than 30 days after the date the federal estate tax return was filed or required to be filed including extensions.\(^c\)

Penalties for inconsistent reporting

If the basis of property claimed on a return exceeds the basis as determined under newly enacted I.R.C. § 1014(f), as discussed above, an “inconsistent estate basis” occurs and is subject to penalty\(^d\) under I.R.C. § 6662(k).

Effective date

The statute specifies that the provisions in the amendment apply to property with respect to which an estate tax return is filed after the date of enactment of the Act\(^e\) (which was July 15, 2015). However, IRS, in Notice 2015-57\(^f\), states that for statements required under I.R.C. § 6035(a)(1) and (a)(2) to be filed with the IRS or furnished to a beneficiary before February 29, 2016, the due date is delayed to February 29, 2016. Taxpayers are urged to hold off filing until the issuance of forms or further guidance from IRS or the Department of the Treasury. The provisions in Notice 2015-57\(^g\) apply to executors of the estates of decedents and to “other persons” who are required under I.R.C. § 6018(a) or (b) to file a return if that return is filed after July 31, 2015.

Is this step one?

The abuses in setting the income tax basis other than as required by I.R.C. § 1014 are not confined to those filing federal estate tax returns. It is reasonable to believe that the next step will be to require the reporting now specified for federal estate tax filers eventually to be applied to all estates.

ENDNOTES

1  I.R.C. § 1014(a).
3  I.R.C. § 2032(a).
4  I.R.C. § 2032A(a). See also I.R.C. § 2031(c) (the Qualified Conservation Easement exclusion).
5  See I.R.C. § 6035(a)(1).
8  I.R.C. § 1014(f)(2).
9  See I.R.C. § 6018(a).
10  I.R.C. § 6035(a).
11  I.R.C. § 6035(a)(3).
12  I.R.C. § 6035(c).
13  I.R.C. § 6035(d).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

ANIMALS

BULL. The defendants, husband and wife, had purchased separate property insurance policies from the plaintiffs, two insurance companies, on their home and another residential property. The policy included exclusion from coverage for bodily injury “arising out of or in connection with a ‘business’ engaged in by an ‘insured.’” The defendants were sued by the estate of a decedent who was killed by a bull owned by the defendants which had escaped from property owned by a corporation which the defendants co-owned with the husband’s father. The bull was used to impregnate cattle also held on the property to produce calves used in team roping and for slaughter. The husband competed as a team roper as a hobby. An employee of the corporation cared for the bull and cattle and the expenses of the operation were paid by the corporation. The expenses and income from the cattle operation were reported on the taxpayers’ Schedules F and produced losses and profits over several years. The insurance companies brought the current action for a declaratory judgment that they had no duty to defend or indemnify the defendants because the injuries were a result of a business operation with the cattle and bull. Although the court acknowledged that the policy language was ambiguous, the court cited case law that held that enforcement of such business exclusion clauses depended on a finding of a profit motive in an activity out of which an injury arose. The court held that the defendants operated the cattle and bull activity with the intent to make a profit because the defendants filed Schedule F to obtain tax benefits from the activity as a business. The court noted that the defendants obtained some profits from the operation, and in the years of losses, received tax benefits by offsetting income from other sources. Other evidence supported the profit motive in that the taxpayers hired people to maintain full financial records of the operation. Although the court gave credence to the defendants’ testimony that the calves were part of the husband’s hobby, the court held that the activity went beyond a hobby to become a business for...