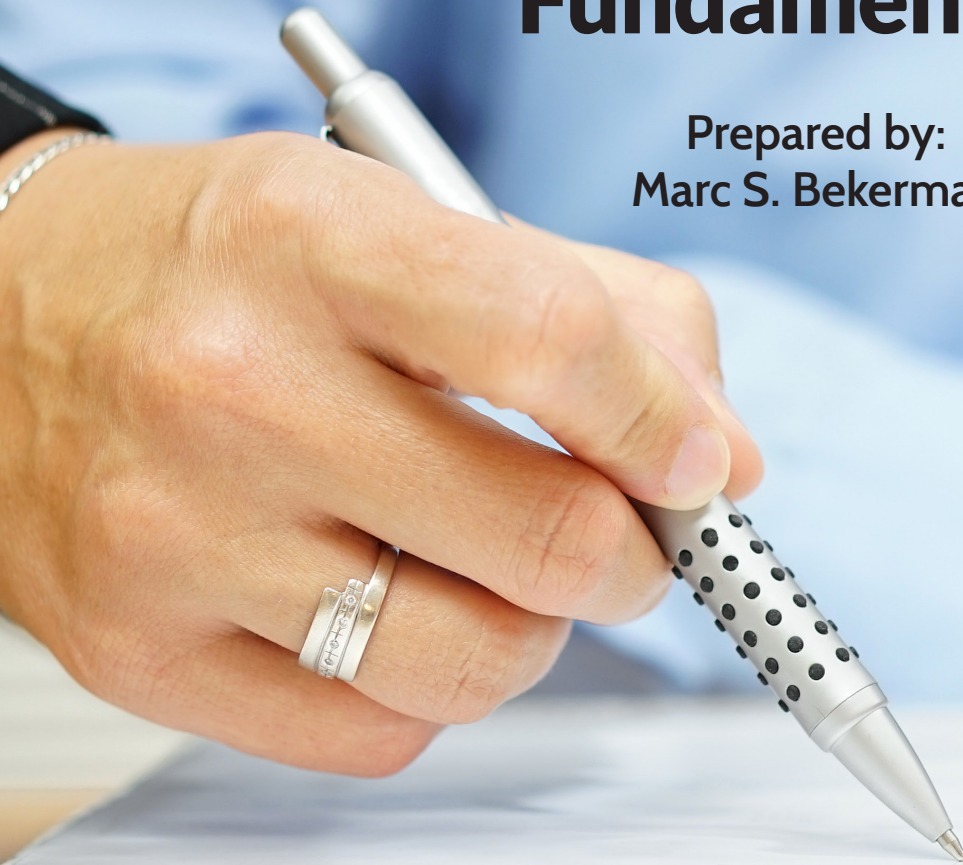


Form 706: Estate Tax Return Fundamentals

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Form 706: Estate Tax Return Fundamentals

1. Strongly recommend becoming familiar with Form 706 (United States Estate (and Generation-Skipping Transfer) Tax Return), the Instructions to Form 706, and Publication 559 (Survivors, Executors and Administrators)
 - a. Available on the IRS website
 - b. Always make sure that you are dealing with the appropriate form and instructions for the particular decedent (you may be involved in an older estate that is not using the “current” form and instructions)
2. The federal gift tax and federal estate tax are excise taxes on the transferor’s privilege of transferring wealth during life or at death. The federal gift tax is outside the scope of this presentation.
3. State law concepts will come into play for several purposes
 - a. Generally define who is the transferor and who is the transferee
 - b. May indicate nature of ownership of property
 - c. May effect deductibility of expenses
4. When is an Estate Tax Return Required
 - a. Gross Estate Exceeds Threshold Amount - If the decedent is a U.S. citizen or resident¹, an estate tax return (Form 706) must be filed if the gross estate of the decedent, increased by the decedent's adjusted taxable gifts, is valued at more than the filing threshold for the year of the decedent's death.

¹ The taxation of an estate of a resident alien may be subject to the terms of a tax treaty between the United States and the country of citizenship. If so, the terms of the treaty will likely control the estate tax implications including any necessary filing requirements. More detail on this point is outside the scope of this course.

- i. Under the 2017 Tax Cut and Jobs Act, the filing threshold for 2018 increases to \$10,000,000, before taking into account the necessary inflation adjustment. The filing threshold for 2018 that includes the inflation adjustment is \$11,180,000
 - ii. The filing threshold for 2017 was \$5,490,000
 - iii. The filing threshold for 2016 was \$5,450,000
 - iv. The filing threshold for 2015 was \$5,430,000
- b. **Seeking Portability of Unused Exemption Amount**
 - i. An estate tax return also must be timely filed if the estate elects to transfer any deceased spousal unused exclusion amount (DSUEA) to a surviving spouse, regardless of the size of the gross estate or amount of adjusted taxable gifts. The election to transfer a DSUEA to a surviving spouse is known as the portability election.
 - ii. If the filing of the estate tax return is only to make the portability election, see Treasury Regulation 20.2010-2(a)(7)(ii) regarding some possible simplifications to the preparation of the return.

- iii. There may be ways to obtain relief from the failure of filing a timely estate tax return. See Revenue Procedure 2017-34. However, the author would strongly recommend filing the estate tax return in the estate of the first spouse to die when possible as contemplated by the Internal Revenue Code to guarantee the availability of portability of the unused exemption amount.
 - c. State Estate Tax Considerations – Some states have an independent estate tax which may necessitate the filing of a federal estate tax return. For example, if the gross estate is under the federal threshold, but the estate wishes to make a QTIP election for state estate tax purposes due to a lower state estate tax exemption amount, a federal estate tax return may be required if the state does not permit a “State-Only QTIP election”
 - d. Foreign taxpayers - An estate tax return may need to be filed on Form 706NA for a decedent who was neither a resident or a citizen of the United States, but had assets situated in the United States. This can be a complicated area and is outside the scope of this presentation.
5. The due date of the estate tax return is nine months after the decedent's date of death.
- a. The estate's representative may request an extension of time to file the return for up to six months. An automatic six month extension of time to file the return is available to all estates by filing Form 4768 on or before the due date of the estate tax return.

- b. Even if an extension of time to file is properly obtained, the correct amount of estate tax is still due by the due date unless a separate extension of time to pay estate tax is obtained
 - i. Extensions of time to pay are granted pursuant to statute.
 - 1. For example, Section 6166 permits the payment of estate tax over time where the estate includes certain closely held business interests
 - 2. For example, Section 6163 permits the deferral of the payment of estate tax on a reversionary or remainder interest until such interest occurs
 - ii. The availability of such an extension, whether discretionary or as a matter of right, are outside the scope of this course.
 - iii. The grant of an extension of time to pay usually does not forego interest.
 - 1. Interest is simply the time value of money and IRS will tell you that it cannot be abated
 - 2. For certain extensions of time to pay, such as pursuant to Section 6166, there may be a prescribed interest rate to be charged to the estate
 - iv. The grant of an extension of time to pay will abate the penalties that would otherwise accrue.

- v. Absent the granting of an extension of time to pay, interest and often penalties will accrue on any amounts still owed by the due date that are not paid at that time.

6. Gross Estate for Estate Tax Purposes

a. Probate Estate (Testamentary Assets)

- i. Pass under will or by intestacy (real or personal, tangible or intangible)
- ii. Exempt assets included (homestead, etc).
- iii. Tenancies in common (compare joint tenancies)
- iv. Future interests and present interests
- v. Receivables (secured, unsecured)
- vi. Household furnishings, personal effects, autos, etc.
- vii. Life insurance payable to the estate
- viii. Insurance on lives of others

b. Non-Probate Estate (Non-Testamentary Assets)

- i. Decedent's life insurance and retirement benefits
 - 1. IRAs, 401(k)s, etc – Note that these may also be subject to income tax (Traditional versus Roth)
 - 2. Life insurance - if insured possessed “incidents of ownership.”
- ii. Joint tenancies (spousal and non-spousal rules)
- iii. Multiple party accounts

- iv. Other contractual arrangements (e.g., private annuity with death benefit)
- c. Lifetime transfers subject to “string” provisions.
 - i. Revocable transfers
 - ii. Retained life estates
 - iii. Reversions
 - iv. Transfers within 3 years of death (only applicable to life insurance and string provisions)
 - v. General powers of appointment
 - 1. Can be exercised in favor of self, creditors, estate or creditors of estate
 - 2. Whether exercised or not
 - 3. “HEMS” exception
 - vi. “QTIP” property (qualified terminable interest property)
 - vii. Gift taxes paid within 3 years of death
- d. What is excluded from the Estate?
 - i. Generally, the Gross Estate does not include property owned solely by the decedent's spouse or other individuals
 - ii. Lifetime gifts that are completed for tax purposes (in other words, the string provisions noted above are not applicable)²

² Such gifts are not part of the gross estate for estate tax purposes at their current values, but may be used in the computation of the estate tax as discussed below if they were “taxable gifts”.

- iii. Life estates or discretionary interests given to the decedent by others in which the decedent has no further control or power at the date of death (such as a general power of appointment) are not included
- e. Valuation
 - i. Fair market value of property generally determined as of date of death
 - ii. "The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts."
 - iii. Important as this will both value for estate tax purposes and usually determine basis in hands of beneficiary or estate pursuant to Internal Revenue Code
 - iv. May be determined by:
 - 1. Statements (such as bank accounts)
 - 2. Markets (such as publicly traded securities)
 - 3. Appraisals (such as real property, tangible personal property and business interests)
 - 4. Arm length sales to third parties shortly after death (usually instead of an appraisal)

- v. Alternate valuation date” (AVD) is earlier of 6 months after death or date of disposition of asset
 - i. Can elect alternate valuation only if it will reduce estate tax.
 - ii. AVD election is “all or nothing.”
- vi. “Special use valuation.”
 - i. Normally assets valued at their “highest and best” use.
 - ii. Real property used as a family farm or ranch or in a closely held business may be valued at its “current” use.
 - 1. In the case of a qualifying family farm, Section 2032A allows an inflation-adjusted reduction from value of up to \$1,140,000 for 2018.
 - 2. A similar deduction for a qualifying family owned business was repealed many years ago.

7. Deductions

- a. As noted above – state law can play a very important role in ascertaining the deductions available on the estate tax return
- b. Funeral and Administration Expenses
 - i. Fiduciary fees and commissions
 - ii. Attorney fees
 - iii. Accountant fees
 - iv. Court fees
 - v. Appraisal fees
- c. Debts of the Decedent
 - i. Secured
 - ii. Unsecured
- d. Losses during administration
- e. Marital transfers
 - i. Assume valid marriage
 - 1. Question of state law
 - 2. *“For federal tax purposes, the terms “spouse,” “husband,” and “wife” includes individuals of the same sex who were lawfully married under the laws of a state whose laws authorize the marriage of two individuals of the same sex and who remain married. Also, the Service will recognize a*

marriage of individuals of the same sex that was validly created under the laws of the state of celebration even if the married couple resides in a state that does not recognize the validity of same-sex marriages. However, the terms “spouse,” “husband and wife,” “husband,” and “wife” do not include individuals (whether of the opposite sex or the same sex) who have entered into a registered domestic partnership, civil union, or other similar formal relationship recognized under state law that is not denominated as a marriage under the laws of that state, and the term “marriage” does not include such formal relationships.” See IRS Frequently Asked Questions on Estate Taxes.

- ii. Unlimited “marital deduction.”
- iii. Spouse must be qualified.
- iv. Transfer must be in proper form.
- v. Transfer in trust generally doesn’t qualify.

- f. Charitable transfers.
 - i. Unlimited “charitable deduction.”
 - ii. Charity must be qualified.
 - iii. Transfer must be in proper form.
 - iv. Split interests transfers.
 - 1. Charitable and non-charitable interests.
 - 2. Only charity’s interest deductible.
 - g. State death taxes (where applicable).
 - h. There are special rules concerning deductibility of contingent claims not paid when return filed. These rules can be reviewed in Revenue Procedure 2011-48 which deals with how to make a protective claim for refund under these circumstances. You will also need to complete Schedule PC to make such a protective claim.
8. Gross Estate less Deductions is the “Taxable Estate.”
9. Prior taxable gifts are generally not included in gross estate (but some are if a string provision applies as noted above).
10. Taxable Estate plus post 1976 taxable gifts is the “Tax Base.”
- a. It is best to have copies of all gift tax returns previously filed with the Internal Revenue Service as part of the file when preparing the estate tax return to permit the calculation of the taxable gifts. In addition, copies of these returns will be required to be filed with the estate tax return.

- b. You should consider reviewing the last three years of checks and statements from the decedent's financial accounts to confirm that there are no unreported taxable gifts (i.e., gifts from the decedent to one or more donees which do not qualify for the annual exclusion in effect at the time)
 - i. The annual exclusion was \$14,000 per donee from 2013-2017
 - ii. The annual exclusion was raised to \$15,000 per donee for 2018
- 11. "Tentative Tax" is computed by applying tax rate to the Tax Base.
- 12. Tentative Tax is reduced by certain credits to calculate actual tax liability, if any.
 - a. Applicable Credit Amount (formerly known as the Unified Credit Amount).
 - i. Basic exclusion amount
 - 1. The basic exclusion amount is \$11,180,000 for 2018.
 - 2. The basic exclusion amount was \$5,490,000 for 2017 which was equivalent to a credit of \$2,141,800 based upon the 2017 rates
 - ii. Deceased spouse's unused exclusion amount ("DSUEA") which permits portability of the unused exclusion amount from a deceased spouse to the surviving spouse.
 - 1. Note that the DSUEA does not increase in value over the passage of time
 - b. Gift taxes paid.
 - c. Taxes paid on prior transfers.

- d. Foreign death taxes.
- 13. Essentially, a flat 40% tax after available exemption is applied.
- 14. Generation Skipping Transfer Tax
 - a. Transfers of income or principal to a transferee who is at least two generations younger than the transferor.
 - b. The “GST Exemption” is a separate exemption from the applicable credit amount for the estate tax which is currently \$11,180,000. As such, a proper allocation of GST Exemption exempts most transfers from the GST tax.
 - c. The nuts and bolts of the Generation Skipping Transfer Tax is outside the scope of this course. However, the tax is noted in these materials since such transfers are required to be reported by an estate of Form 706.
- 15. Preparing the Estate Tax Return
 - a. Elections
 - i. Alternate Valuation
 - ii. Special Use Valuation under Code Section 2032A
 - iii. Section 6166
 - iv. Section 6163
 - b. General Information
 - i. Most are self-explanatory
 - ii. If answering yes, confirm whether there are any additional supporting items required for the return and that appropriate Schedule (or Schedules) are completed

1. Protective Claim for Refund (Schedule PC)
 2. Gift tax returns
 3. Copies of trusts
 4. Schedule E – Joint property with rights of survivorship
 5. Schedule G – Certain string transfers
 6. Schedule H – Powers of Appointment
 7. Schedule I – Annuities
- c. Completion of schedules
- d. Backup items
1. Copies of the death certificate
 2. Certified copy of the decedent's will
 3. Copies of relevant trusts
 4. Copies of appraisals
 5. Form 712, Life Insurance Statement.
 6. Copies of relevant documents regarding litigation involving the estate
 7. Documentation of any unusual items shown on the return (partially included assets, losses, near date of death transfers, others).
 8. Form 2848, Power of Attorney and Declaration of Representative.

16. "Basis Consistency" Reporting Requirement

- a. Until recently, there was no coordination between the estate and income tax systems.
 - i. An executor often is trying to justify a lower value for estate tax purposes (to decrease estate taxes due)
 - ii. When a beneficiary sells the asset later on, he or she may claim it was worth more at the time of death (or alternate valuation if elected by the estate), providing the beneficiary with a higher basis and decreasing the capital gain on which the beneficiary is taxed.
 - iii. Up until recently, the value used by the executor only created a presumption for income tax purposes; a beneficiary could rebut that presumption by providing "clear and convincing" evidence that the value was higher.
- b. In 2015, Congress enacted the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, which imposed a new requirement that executors file information statements with the IRS and provide beneficiaries information about the basis of assets they receive.
- c. The statutory deadline for this new information return (Form 8971, Information Regarding Beneficiaries Acquiring Property From a Decedent) is 30 days after the date the estate tax return is required to be filed, or 30 days after the return is actually filed, if earlier.

- d. This new reporting requirement applies to all estate tax returns filed after July 31, 2015 that were required to be filed, whether or not estate taxes were due. It does not apply to returns that were “optionally” filed, such as returns filed solely to elect portability or to allocate GST exemption.

18. When can I expect an Estate Tax Closing Letter? - **See IRS Frequently Asked Questions on Estate Taxes.**

- a. *Estate tax closing letters will only be issued upon request by the taxpayer or taxpayer’s representative.*
- b. *There are two options for making a request for an estate tax closing letter:*
1. *By fax to (855) 386-5127 or (855) 386-5128, or*
 2. *By calling (866) 699-4083*
- c. *Both types of request require a person authorized to receive information from the IRS to make the request. The following information must be provided with the request:*
- *Decedent’s name, Social Security Number and Date of Death.*
 - *Requestor’s name, address, and substantiation the requestor is an authorized individual such as an Executor, Trustee, or Power of Attorney.*
 - *A copy of the will if by fax.*

- *If the requestor is an Executor, provide a copy of the Letters Testamentary issued by the Court if submitting information by fax; or if calling, the Executor must be on the telephone.*
 - *If the requestor is a Trustee, provide a Certificate of Trust or similar official documentation by fax, or the Trustee must be on the telephone.*
 - *If the requestor holds an IRS Power of Attorney (POA), provide the Centralized Authorization File (CAF) number by fax, or the POA must be on the telephone. A Paralegal working with a POA is not an authorized individual.*
- d. Only one method should be used per estate.*
- e. Please wait at least four months after filing the return to make the closing letter request to allow time for processing. For examined returns, please allow up to 30 days after the examination is complete for processing.*
- f. The closing letter will be prepared and issued to the executor at the address of record.*
- g. See Notice 2017-12 for the alternative to the Estate Tax Closing Letter which is an account transcript issued by the IRS.*

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