

# The 2020 Gift that Keeps on Giving - Tips and Best Practices to Manage IRS Audit Risk in 2021

ABA RPTE Business Planning Group Meeting

March 17, 2021

# Presenters

Ken N. Jefferson

Associate

Ivins, Phillips & Barker



**Ivins Phillips Barker**  
CHARTERED

Chelsea L. McGrath

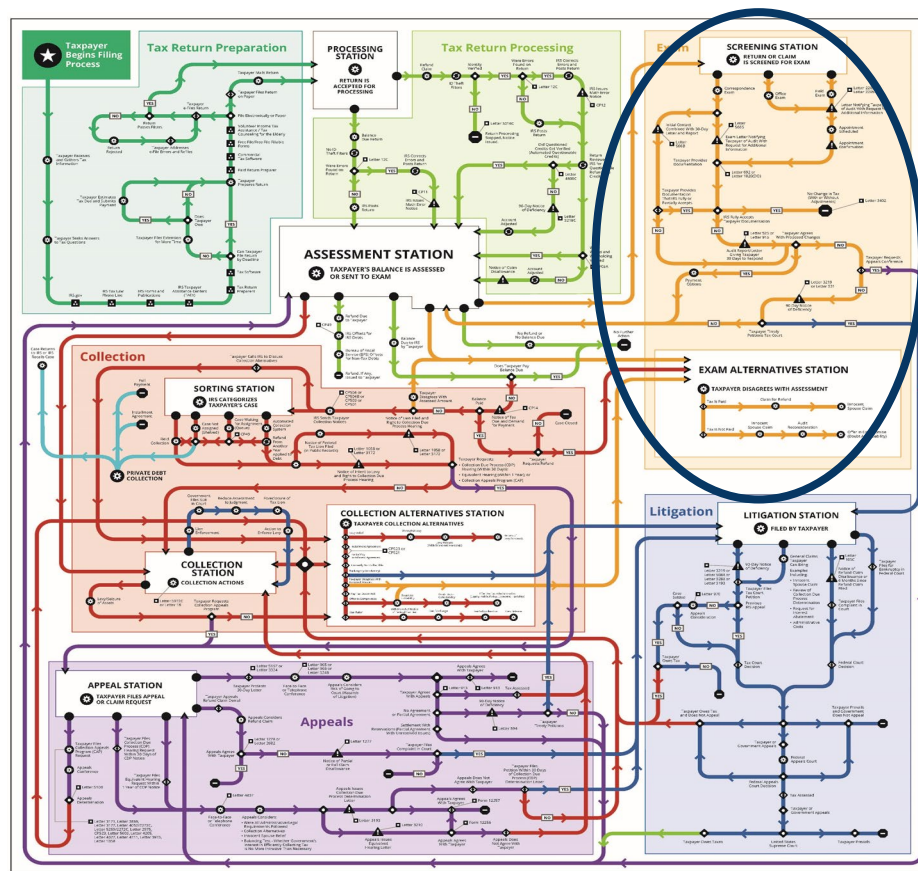
Associate

Venable LLP

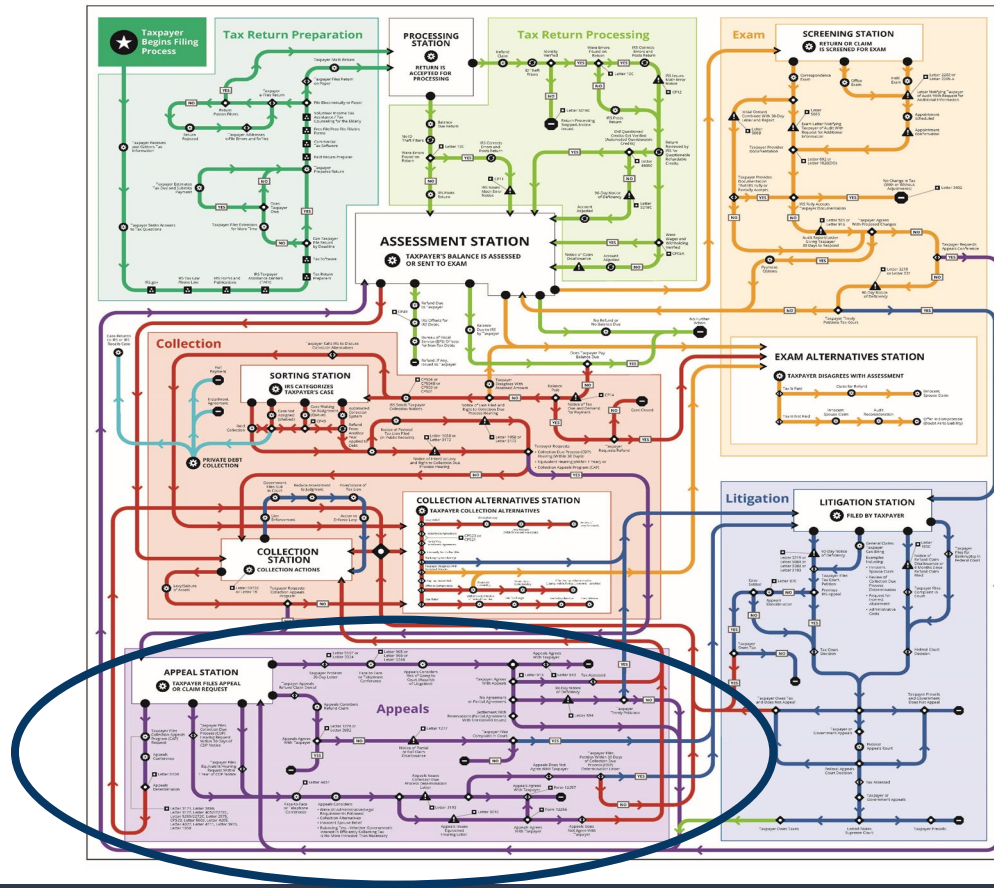
**VENABLE**<sub>LLP</sub>

# Agenda

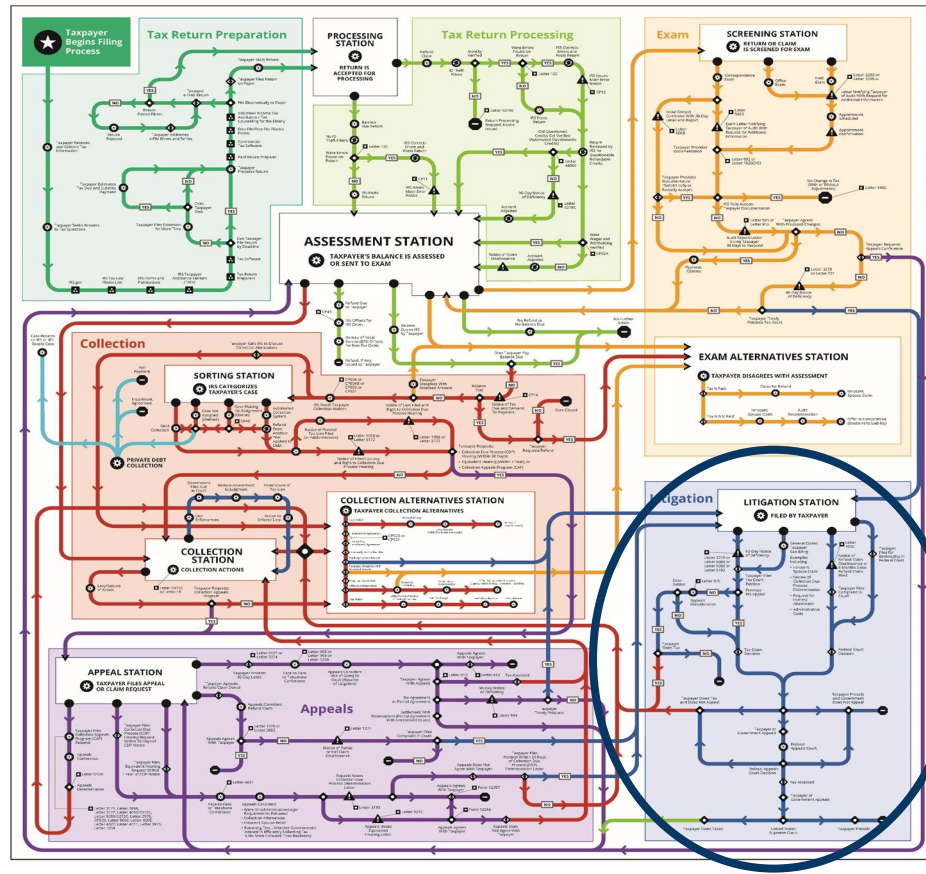
- Overview of Audit Process
- Audit Letter and IDRs
- Appeals Process and/or Litigation
- Classification of Issues and Return Selection
- Case Study and Practice Tips
- Adequate Disclosure



# Life Cycle of a Tax Return



# Life Cycle of a Tax Return



# Life Cycle of a Tax Return

# Relevant Code Sections

- **IRC§ 6201(a)** - Authorizes Treasury Secretary to assess tax, interest, additions to tax, and penalties
- **IRC§ 6212(b)** - Requires IRS to provide TP with Notice of Deficiency (NOD)
  - Aka 90-Day Letter, STAT Notice, or Ticket to Tax Court
- **IRC§ 6213** - TP has 90 days from NOD to petition TC for redetermination. If no petition, tax may then be assessed
- **IRC§ 6215(a)** - If TP petitions TC, once TC decision is final, re-determined amount may be assessed

# Statute of Limitations

**General Rule:** 3 years from date of filing return

**How Determined:**

- SOL begins to run when return is deemed filed with IRS, regardless of timeliness
- Deemed filing date determined by:
  - (1) Return due date,
  - (2) Postmark/ mailing date, and
  - (3) Date received
  - Mailbox and weekend/ holiday rules apply



# SOL Exceptions

- **Substantial Omission** - Extends SOL to 6 years if value exceeding 25% of gross estate or reported gifts omitted or inadequately disclosed
- **Fraud** - No SOL if additional tax due to fraud or willful attempt to evade tax (IRC§ 6501(c)(1)-(2))
- **No Return Filed** - Assessment period does not begin until a return is filed
- **By Agreement** - May be extended by written agreement, prior to expiration of time for assessment, for gift and GST taxes

# SOL Exceptions

- **Credits** - If additional tax due as result of state or foreign tax refund claimed as a credit, no SOL for assessment
- **Special Valuation and Inadequate Disclosure** - Assessment period remains open as to inadequately disclosed items (discussed in greater detail later)
- **Statutory NOD** - If 90-day letter issued, SOL tolled from date of issue until 60 days after TC decision becomes final
- **Transferees** - Period for assessment against gift donees or estate transferees expires one year after period for assessment against the donor or estate (i.e. 4-year assessment period, if no other exception applies)



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

SMALL BUSINESS/SELF-EMPLOYED DIVISION

SB/SE E&G NE 1207: [REDACTED]  
1111 Constitution Avenue, N, 5<sup>th</sup> Floor  
Washington, DC 20224

Employee ID Number: [REDACTED]  
Telephone Number: [REDACTED]  
Fax Number: [REDACTED]

December 9, 2016

Re: Estate of [REDACTED]; Date of Death: [REDACTED] 2015

Dear Ms. [REDACTED]:

The Internal Revenue Service has selected the federal estate tax return filed on behalf of the Estate of [REDACTED] for examination. In order to complete our review of the return as quickly as possible, please forward the following information to me by January 13, 2016. If you prefer, you may submit the requested documents in a .pdf format via electronic media. Please provide:

1. Copies of the decedent's income tax returns, Forms 1040, for the years 2013 through 2015.
2. Any Forms 1041 filed on behalf of the estate.
3. A copy of the State estate tax return(s) filed.
4. Copies of predeceased spouses, [REDACTED] and [REDACTED] Sr.'s, Forms 706 and audit adjustments, if any.
5. Bank/S&L Statements, passbooks and cancelled checks for three years prior to the date of death and one month thereafter for all accounts owned by the decedent, including but not limited to:
  - a. Captrust Financial Advisors (Account # [REDACTED])
  - b. Captrust Financial Advisors (Account # [REDACTED])
  - c. Captrust Financial Advisors (Account # [REDACTED])
  - d. Captrust Financial Advisors (Account # [REDACTED])
  - e. Captrust Financial Advisors (Account # [REDACTED])
  - f. First Citizens Bank (Account # [REDACTED])
6. A completed Form 712 for all life insurance policies on the decedent's life including:
  - a. Sch. D, Item 1 – Mass. Mutual Life Ins. (Policy # Ending in [REDACTED])
7. Please provide copies of any Homeowner's Insurance Policies owned by the decedent.

# Audit Initiation Letter

You should be aware that the Office of Appeals now requires 270 days remaining on any estate tax statute of limitations, and 365 days on any gift tax statute of limitations, when a case is received by their office. In an examination involving an estate return and gift return(s), the 365 day minimum remaining statute will apply for all returns. In light of the foregoing, we hope to complete our examination by a mutual commitment date of March 9, 2018, if not sooner.

If you have any questions, feel free to call me at the number shown above. Thank you for your cooperation.

Sincerely,

# Audit Initiation Letter

Taxpayer Name:	TIN: 000-00-0000	DOD:
Employee Name:	Return: Estate	Statute:

ESTATE MANDATORY LEAD SHEET			
Executor #1 Contact Information		Executor #2 Contact Information (if applicable)	
Telephone number		Telephone number	
FAX number		FAX number	
Representative #1 Contact Information		Representative #2 Contact Information (if applicable)	
Telephone number		Telephone number	
FAX number		FAX number	
Form 2848 signed	<input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> N/A	Form 2848 signed	<input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> N/A
Date to CAF (MM/DD/YYYY)		Date to CAF (MM/DD/YYYY)	
Part IV signed on Form 706	<input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> N/A	Part IV signed on Form 706	<input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> N/A

CASE DATES AND EXAMINATION TARGET DEADLINES			
Statute of Limitations:			
Assigned Date:		18 Month Date:	
Received Date:		Last Appeals Acceptance Date:	
Exam Start Date		210 Days to Statute:	
Deadline:		Issue 30 Day Letter:	
MPTC Meeting:		Issue 90 Day Letter:	
Mutual Commitment or Estimated Closing Date:			

Taxpayer Name:	TIN: 000-00-0000	DOD:
Employee Name:	Return: Estate	Statute:

CASE SUMMARY
Summary of Decedent's Will, Trust, Elections, etc.: (Optional)

TRANSCRIPT REVIEWS AND RELATED RETURN RESEARCH				
<b>TRANSCRIPT REVIEW</b> (e.g., AMDISA, BMFOLT, TXMOD, INOLE, IRPTR, etc.) <ul style="list-style-type: none"> <li>Verify assessment amount match the tax shown on the return.</li> <li>Consider whether penalties were previously assessed.</li> <li>Verify whether delinquent return indicator is reported on the AMDISA.</li> <li>Review to determine if a freeze code is reported on the AMDISA.</li> <li>Determine whether a supplemental return was filed (TC976).</li> </ul>	REFERENCE			
<b>RELATED RETURN RESEARCH</b> Examination expanded to include related return(s)? (See IRM 4.25.8.1, <i>Introduction to Non-delinquent Pickup Returns</i> ) May include portability-related returns, or returns filed by spouses, parents, siblings, grandchildren, trusts, etc.	YES	NO	N/A	REFERENCE
Any delinquent returns secured & processed? (See IRM 4.25.8.2, <i>Introduction to Delinquent Pickup Returns</i> )	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
<b>GIFT TAX RETURNS (FORM(S) 709)</b> Review transcripts, secure and inspect previously filed Gift Tax Returns, Form(s) 709.	YES	NO	N/A	REFERENCE
Identify any gift tax returns with open statutes (Form(s) 709). Determine whether the return(s) should be opened for examination. If yes, follow procedures for pick-up and fill out "Gift Tax Mandatory Lead Sheet."	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Any delinquent Form(s) 709 filed or non-filer cases opened?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

# Examiner Game Plan

Taxpayer Name:	TIN: 000-00-0000	DOD:
Employee Name:	Return: Estate	Statute:

Taxpayer Name:	TIN: 000-00-0000	DOD:
Employee Name:	Return: Estate	Statute:

EXAMINATION ISSUE IDENTIFICATION AND DOCUMENT INDEX			
LEAD SHEET(S)	CLASSIFIED ISSUE	AFTER ASSIGNMENT ISSUE	ISSUE DESCRIPTION
Elections- Special Valuation (IRC § 2032A)	<input type="checkbox"/>	<input type="checkbox"/>	
Elections- Installment Payment (IRC § 6166)	<input type="checkbox"/>	<input type="checkbox"/>	
Elections – Payment Deferral (IRC § 6163)	<input type="checkbox"/>	<input type="checkbox"/>	
Portability – Election of DSUE	<input type="checkbox"/>	<input type="checkbox"/>	
Portability – Use of DSUE	<input type="checkbox"/>	<input type="checkbox"/>	
Page 1 Adjustments (e.g., math error, SDTD etc.)	<input type="checkbox"/>	<input type="checkbox"/>	
Gift Tax Issue (Line 4/Line 7)	<input type="checkbox"/>	<input type="checkbox"/>	
International Issues: (Domicile, Citizenship, Situs, International UC, Treaties, and Expatriation)	<input type="checkbox"/>	<input type="checkbox"/>	
Sch A – Real Estate	<input type="checkbox"/>	<input type="checkbox"/>	
Sch B – Stocks and Bonds	<input type="checkbox"/>	<input type="checkbox"/>	
Sch C – Mortgages, Notes, Cash	<input type="checkbox"/>	<input type="checkbox"/>	
Sch D – Life Insurance	<input type="checkbox"/>	<input type="checkbox"/>	
Sch E – Jointly Owned Property	<input type="checkbox"/>	<input type="checkbox"/>	
Sch F – FLP or Misc. Property	<input type="checkbox"/>	<input type="checkbox"/>	
Sch G – Transfers During Life	<input type="checkbox"/>	<input type="checkbox"/>	
Sch H – Powers of Appointment	<input type="checkbox"/>	<input type="checkbox"/>	
Sch I – Annuities	<input type="checkbox"/>	<input type="checkbox"/>	
Sch J – Attorney Fees, Executor, Misc.	<input type="checkbox"/>	<input type="checkbox"/>	
Sch K – Debts, Mortgages and Liens	<input type="checkbox"/>	<input type="checkbox"/>	
Sch L – Losses, Property Not Subject	<input type="checkbox"/>	<input type="checkbox"/>	
Sch M – Marital Deduction	<input type="checkbox"/>	<input type="checkbox"/>	
Sch O – Charitable Deduction	<input type="checkbox"/>	<input type="checkbox"/>	
Sch P – Foreign Death Tax Credit	<input type="checkbox"/>	<input type="checkbox"/>	
Sch Q – TPT Credit	<input type="checkbox"/>	<input type="checkbox"/>	
Sch R – Generation Skipping Transfer Tax	<input type="checkbox"/>	<input type="checkbox"/>	
Sch U – Conservation Easement	<input type="checkbox"/>	<input type="checkbox"/>	
Closely Held Business	<input type="checkbox"/>	<input type="checkbox"/>	
Qualified Domestic Trust (QDOT)	<input type="checkbox"/>	<input type="checkbox"/>	
Generic Lead Sheet (modify/cite issue)	<input type="checkbox"/>	<input type="checkbox"/>	

REFERRALS				
SPECIALIST REFERRAL SYSTEM	YES	NO	N/A	REFERENCE
Real Estate Engineers	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Business Valuation Experts	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Art Appraisal Services/Art Panel	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Economist or Other (Employee Plans, Employment Tax, TEGE)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
OTHER REFERRALS	YES	NO	N/A	REFERENCE
Team Audit/Lead Attorney	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Outside Fee Appraiser	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Income Tax	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Office of Professional Responsibility	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
SB/SE Lead Development Center	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Other (Explain):	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

ASSET PROBE	
FORM(S) 1040: YES <input type="checkbox"/> NO <input type="checkbox"/> N/A <input type="checkbox"/>	REFERENCE
Secure and inspect last 3 years and analyze correlation of returned estate assets to:	
1. Interest income reported on Schedule B, Part 1, Form 1040 and income on Form 1041 to a corresponding estate asset	
2. Dividend income reported on income tax returns to a corresponding estate asset	
3. Capital gains/losses reported on Schedule D, Form(s) 1040/1041 to an estate asset	
4. Pass through entities reported on Schedule E, Form(s) 1040/1041	
5. Real estate taxes and property taxes deducted on Schedule A, E, F, etc.	
6. Final year income tax refunds	
FORM(S) 1041: YES <input type="checkbox"/> NO <input type="checkbox"/> N/A <input type="checkbox"/>	REFERENCE
Secure and inspect last 3 years of returns and analyze whether:	
1. Debts/expenses properly deducted on both returns	
2. Basis is consistently reported with Form 706 and any adjustments thereto	
3. Income in Respect of Decedent (IRD) items are correctly reported on both Form 706 and Form 1041	
4. Schedule K-1s reflect income distributions	
5. IRD deduction claimed, IRC § 691(c), is adjustment made/correct for deductions in respect to decedent	
6. An adjustment is just a roll-over between Form 1041 and beneficiary in a similar bracket	

# Examiner Game Plan



# Examiner Game Plan

Taxpayer Name:	TIN: 000-00-0000	DOD:
Employee Name:	Return: Estate	Statute:

ASSET PROBE	
<b>ESTATE AND TRUST ACCOUNTING:</b> YES <input type="checkbox"/> NO <input type="checkbox"/> N/A <input type="checkbox"/>	<b>REFERENCE</b>
1. Consider reviewing post-death estate and trust accounting 2. Correlate assets returned on Form 706 with reported items and receipts of assets per accountings 3. Review estate and/or trust financial records	
<b>OTHER CONSIDERATIONS:</b> YES <input type="checkbox"/> NO <input type="checkbox"/> N/A <input type="checkbox"/>	<b>REFERENCE</b>
1. Review checking and brokerage account records for gifts 2. Review disbursements from controlled entities to donees 3. Consider electronic research for real estate 4. Review business succession transfers	

Evaluate Potential for Penalties and Fraud (Penalty and Fraud Forms)	
<p>If examination resulted in a deficiency, are there any facts that suggest a failure to file, failure to pay, negligence, undervaluation, accuracy related, fraud or other penalties may apply?</p> <p> <input type="checkbox"/> Yes           <input type="checkbox"/> No           <input type="checkbox"/> Not Applicable         </p>	
<p>Explain:</p>	
Penalty Approval Lead Sheet	Included? <input type="checkbox"/> Yes
Fraud Awareness Lead Sheet	Included? <input type="checkbox"/> Yes

ISSUE RESOLUTION AND PAYMENT SOLICITATION			
	YES	N/A	REFERENCE
Issue summons to secure outstanding necessary documentation prior to unagreed case closure, where required.	<input type="checkbox"/>	<input type="checkbox"/>	
Offer Manager's Conference	<input type="checkbox"/>	<input type="checkbox"/>	
Offer Fast Track Mediation for unagreed issues when appropriate. See <a href="#">IRM 4.25.13.2</a> and <a href="#">Publication 3605</a> .	<input type="checkbox"/>	<input type="checkbox"/>	
Offer Fast Track Settlement for unagreed issues when appropriate. See <a href="#">IRM 4.25.13.3</a> .	<input type="checkbox"/>	<input type="checkbox"/>	
Consider partial agreement for unagreed cases.	<input type="checkbox"/>	<input type="checkbox"/>	
Solicit payment (full or partial) and provide taxpayer with information regarding electronic payment. See <a href="#">Publication 3611</a> , <a href="#">IRM 4.20.3</a> and <a href="#">IRM 4.25.10.2.4</a> .	<input type="checkbox"/>	<input type="checkbox"/>	

# Information Document Requests

- Formal request document to obtain supplemental information with regard to issues under audit
- Not compulsory and depends on the style of the examiner
- Tip - Provide exactly what the IDR asks for and not more

Form <b>4564</b> (Rev. September 2006)	Department of the Treasury — Internal Revenue Service <b>Information Document Request</b>	Request Number
To: <i>(Name of Taxpayer and Company Division or Branch)</i>		Subject
		SAIN number      Submitted to:
		Dates of Previous Requests <i>(mmdyyy)</i>
<i>Please return Part 2 with listed documents to requester identified below</i>		
Description of documents requested		



# Examiner Report

## Summary of Examiner's Findings - Change vs. No Change

### Report Includes:

- **Form 1273** (Estate) / **Form 3233** (Gift) - As Filed vs. Adjustments Comparison
- **Form 6180** (Estate only) - Breakdown of As Filed vs. Adjustments by Schedule
- **Form 886-A** - Explanation of Adjustments

# DRAFT

## Department of the Treasury- Internal Revenue Service Report of Estate Tax Examination Changes

Form 1273

Estate of: Pacific, Linfield A.		Social Security Number: 000-00-0000	Date of Death: 6/03/2007
Name of Person With Whom Findings were Discussed: Lane Pacific, Executor		Agreement Secured: No	
1	Tentative Taxable Estate Shown on Return or Previously Adjusted		3,150,000
2	Increase/Decrease in Tentative Taxable Estate		106,632
3a	Tentative Taxable Estate as Corrected (Line 1 plus/minus Line 2)		3,256,632
		Shown on Return/ As Previously Assessed	As Corrected
3b	State Death Tax Deduction	0	0
3c	Taxable Estate as Corrected (Line 3a – Line 3b)	3,150,000	3,256,632
4	Adjusted Taxable Gifts	0	0
5	Total	3,150,000	3,256,632
6	Tentative Tax	1,298,300	1,346,284
7	Aggregate Gift Tax Payable (After Dec. 31, 1976)	0	0
8	Tax Before Unified Credit (Line 6 – Line 7)	1,298,300	1,346,284
9a	Basic Exclusion Amount	2,000,000	2,000,000
9b	Deceased Spousal Unused Exclusion (DSUE)	0	0
9c	Applicable Exclusion Amount (Line 9a + Line 9b)	2,000,000	2,000,000
9d	Applicable Credit Amount (from Table A, using Line 9c)	780,800	780,800
10	Adjustment to Unified Credit	0	0
11	Allowable applicable credit amount	780,800	780,800
12	Tax Before SDTC (Line 8 – Line 11) *Cannot be < 0	517,500	565,484
13	State Death Tax Credit	0	0
	Tentatively Allowed		
	Submit Evidence by		
14	Net Tax Post State Death Tax Credit (Line 12 – Line 13)	517,500	565,484
15	Gift Tax Credit (Pre-1977 Gifts)	0	0
16	Foreign Death Tax Credit (Statutory)	0	0
17	Prior Transfer Credit	0	0
18	Foreign Death Tax Credit (Treaty) /Canadian Marital Credit	0	0
19	Total Credits (Sum of Lines 15 through 18)	0	0
20	Net Estate Tax Payable	517,500	565,484
21	Generation Skipping Transfer Taxes (Schedule R, Part 2, Line 12)	0	0
22	Increased Estate Tax (Section 4980A, Schedule S)	0	0
23	Total Federal Estate Tax (Sum of Lines 20 through 22)	517,500	565,484
24	Total Transfer Tax Previously Assessed		517,500
25	Total Transfer Tax Increase/Decrease (Line 23 – Line 24)		47,984
26	Penalties Previously Assessed – Code(s):		0
27	Penalties as Corrected – Code(s):		0
28	Net Penalties Increase/Decrease (Line 27 – Line 26)		0
29	Net Tax and Penalties Payable Increase/Decrease (Line 25 + Line 28)		47,984

# DRAFT

## Department of the Treasury- Internal Revenue Service Line Adjustment - Estate Tax

Form 6180

Estate of Pacific, Linfield A.		Social Security Number: 000-00-0000	Date of Death: 6/03/2007	
		Shown on Return/ As Previously Assessed	Changed	As Corrected
1	Schedule A, Real Estate	180,000	20,000	200,000
2	Schedule B, Stocks and Bonds	0	0	0
3	Schedule C, Mortgages, Notes, and Cash	2,300,000	0	2,300,000
4	Schedule D, Insurance on the Decedent's Life	0	0	0
5	Schedule E, Joint Owned Property	0	0	0
6	Schedule F, Other Miscellaneous Property	1,020,000	2,000,000	3,020,000
7	Schedule G, Transfers During Decedent's Life	0	0	0
8	Schedule H, Powers of Appointment	0	0	0
9	Schedule I, Annuities	0	0	0
10	Gross Estate	3,500,000	2,020,000	5,520,000
11	Schedule U, Qualified Conservation Easement Exclusion	0	0	0
12	Gross Estate less exclusion	3,500,000	2,020,000	5,520,000
13	Schedule J, Funeral and Administrative Expenses	50,000	(20,000)	30,000
14	Schedule K, Debts of Decedent	0	0	0
15	Schedule K, Mortgages and Liens	0	0	0
16	Total of Schedules J and K (Lines 13, 14, + 15)	50,000	(20,000)	30,000
17	Allowable deductions from Schedules J and K	50,000	(20,000)	30,000
18	Schedule L, Net Losses During Administration	0	0	0
19	Schedule L, Expenses and Property Not Subject to Claims	0	0	0
20	Total (Lines 17, 18, + 19)	50,000	(20,000)	30,000
21	Schedule M, Marital Deduction	0	0	0
22	Schedule O, Charitable Bequests	300,000	1,933,368	2,233,368
23	ESOP Deduction	0	0	0
24	Schedule T, QFOB Deductions	0	0	0
25	Total Allowable Deductions (Lines 20, 21, 22, 23, + 24)	350,000	1,913,368	2,263,368
26	Tentative Taxable Estate (Line 12 - 25)	3,150,000	106,632	3,256,632

# Proposed Change Report

## DRAFT

Form <b>886-A</b> (Rev. January 1994)	<b>EXPLANATION OF ITEMS</b>	Schedule number or exhibit <b>A - Real Estate</b>
Name of taxpayer <b>Pacific, Linfield A.</b>	Tax Identification Number <b>000-00-0000</b>	Year/Period ended <b>6/03/2007</b>

### A - Real Estate

Item #	Description	Returned/Assessed	Corrected
1	Personal Residence	180,000	200,000
	Total of these Items	180,000	200,000
	Shown on Return		180,000
	Change to Schedule		20,000

The real property indicated above has been adjusted to its fair market value of the valuation date based upon a sale of the property in an arm's-length transaction within a reasonable time of the valuation date. Section 20.2031-1(b) of the Federal Estate Tax Regulations.

## DRAFT

Form <b>886-A</b> (Rev. January 1994)	<b>EXPLANATION OF ITEMS</b>	Schedule number or exhibit <b>F - Other Miscellaneous Property</b>
Name of taxpayer <b>Pacific, Linfield A.</b>	Tax Identification Number <b>000-00-0000</b>	Year/Period ended <b>6/03/2007</b>

### F - Other Miscellaneous Property

Item #	Description	Returned/Assessed	Corrected
1	Account receivable owing to QTIP	0	2,000,000
	Total of these Items	0	2,000,000
	Shown on Return		0
	Change to Schedule		2,000,000

The gross estate of a decedent includes the value of all property to the extent of the decedent's interest therein at the time of his/her death. Code section 2033. Accordingly, the value of gross estate has been adjusted to reflect the inclusion of the fair market value of the above asset(s), as of the applicable valuation date.

# Proposed Change Report

## DRAFT

Form <b>886-A</b> (Rev. January 1994)	<b>EXPLANATION OF ITEMS</b>		Schedule number or exhibit J - Funeral and Administrative Expenses
Name of taxpayer	Tax Identification Number	Year/Period ended	
Pacific, Linfield A.	000-00-0000	6/03/2007	

### J - Funeral and Administrative Expenses

Item #	Description	Returned/Assessed	Corrected
1	Brokerage Commissions on sale	20,000	0
	Total of these Items	20,000	0
	Shown on Return		20,000
	Change to Schedule		(20,000)

Expenses for selling property of the estate are deductible if the sale is necessary in order to pay the decedent's debts, expenses of administration, or taxes, to preserve the estate, or to effect distribution.  
Treas. Reg. 20.2053-3(d)(2).

## DRAFT

Form <b>886-A</b> (Rev. January 1994)	<b>EXPLANATION OF ITEMS</b>		Schedule number or exhibit O - Charitable Deduction
Name of taxpayer	Tax Identification Number	Year/Period ended	
Pacific, Linfield A.	000-00-0000	6/03/2007	

### O - Charitable Deduction

Item #	Description	Returned/Assessed	Corrected
1	Corrected Charitable Deduction	300,000	2,233,368
	Total of these Items	300,000	2,233,368
	Shown on Return		300,000
	Change to Schedule		1,933,368

Deduction(s) for property transferred by the decedent during his/her lifetime or by will to charitable organizations have been adjusted to reflect the amounts allowable under Code section 2055.

# Proposed Change Report

# Proposed Change Report

DRAFT

Department of the Treasury - Internal Revenue Service

Explanation of Items

Form 886A

Estate of: Pacific, Linfield A.	Social Security Number: 000-00-0000	Date of Death: 6/03/2007
<b>Marital/Charitable Deductions</b>		
Gross Estate:		5,520,000.00
Less Taxable Transfers:		3,256,632.00
Less Schedule J, K, L As Corrected:		30,000.00
Less 1041 Expenses from Residue		0.00
Less Federal Estate Tax:		565,484.40
Less State Death Taxes:		0.00
Net Residue:		2,170,000.00
Marital Percentage of Residue:		0.0000%
Specific Marital Bequests:		0.00
Total Marital Deduction:		0.00
Charitable Percentage of Residue:		100.0000%
Specific Charitable Bequests:		63,368.00
Total Charitable Deduction:		2,233,368.00

# Audit Determination - What Next?

## Examiner findings:

- No Change - After review, examiner proposes no changes
- Agreed - Changes proposed and TP agrees
- Partially Agreed - Changes proposed and TP agrees with some but not others
- Unagreed - TP disagrees with proposed changes by IRS

# Audit Determination - What Next?

## Examiner options:

- No change/Agreed/Partially Agreed
  - TP signs Form 890, TP agrees with proposed adjustments (increase in tax or refund), waives statutory restrictions on assessment and collection of tax deficiency
  - Closing Letter Issued
- Unagreed/Partially Agreed - IRS has 2 options:
  - 30-day Letter - Issued if >9 months left on SOL
  - 90-day Letter - Issued if <9 months left on SOL

# Audit Determination - What Next?

Taxpayer options after 30 -day letter issued:

- File protest - 3 potential starting points:
  - Appeals (akin to arbitration)
  - Fast-Track Settlement (akin to mediation)
  - Litigate
- Do nothing
  - 90-day Letter may be issued after 30 days



# 30- Day Letter

- Ticket to appeals
- Notifies TP of right to protest within 30 days, TP's rights, and appeal procedure
- Agents are usually agreeable to not issue letter until later upon a TP's request
- Not a hard and fast 30 days
- Allows TP time to build arguments for protest
- Agents commonly use to extend the SOL deadline
- Public companies have to disclose to shareholders

# Audit Determination - What Next?

Taxpayer options after 90 -day letter issued:

- Petition Court - 3 options:
  - Tax Court (Deficiency Suit)
  - District Court (Refund Suit)
  - Court of Federal Claims (Refund Suit)
- Do nothing
  - After 90 days, tax may be assessed

# 90 - Day Letter

- After 90 days, Tax Court loses jurisdiction
  - Cannot be extended
  - Tip - Easy way for malpractice
- 30-day and 90-day letter are not mutually exclusive
- Why issued?
  - TP request to bypass IRS Appeals
  - IRS determines insufficient time remaining on SOL for administrative appeal or other circumstances warrant (such as failure to cooperate or produce documents)

# Options & Considerations

- Traditional Appeals Process with Appeals Officer
- Fast-Track Settlement
- Litigation Options
  - Tax Court
  - Court of Federal Claims
  - Federal District Court

# Traditional Appeals Process

- Examination team removed from final decision
- TPs generally likely to receive more favorable outcome
- May consider hazards of litigation unlike at exam level
- Additional costs to TP versus resolving at exam level
- Timing concerns if later opt to litigate

# Fast-Track Settlement

- Involves the exam team
- More akin to a mediation
- Does not foreclose the option to pursue traditional appeals process

# Litigation Options

- Tax Court (deficiency suit) vs. Court of Federal Claims or Federal District Court (refund suit)
- Considerations in choosing forum
  - Issues and Expertise
  - Precedents
  - Costs and time

# Tax Court

- No prepayment required to file
- Judges have 15 year terms, know tax law better, and are more practical
- Cheaper, practice is loose (judges lean towards stipulations), evidence rules differ
- Limited discovery; TP cannot be deposed unless TP consents
- Has national subpoena power
- No jury trial
- Appealed to circuit of TP's residency
- No equitable relief



# U.S. Court of Federal Claims

- Law of Federal Circuit (including IRS acquiescence)
- Discovery is less formal
- Cases are quicker
- Federal Circuit are exclusively bench trials

# Federal District Court

- Jury trials are optional
- Judges deal with all types of cases and will disregard tax cases as being unimportant
- More expensive

# Classification

- Reviewed and selected by hand by ETAs
- If selected, sent to field for further development
- Done in 1 to 2 week stints
- 8 hours/day, 30 minute review/return for audit potential

# Example

## Salient Facts:

- Form 706 filed in 2017 for \$18M estate
- 4 months after original filing, PR filed supplemental return to report after-discovered bank accounts valued at roughly \$379K
- Selected for audit with points of concern ranging from jewelry and real estate appraisals and payment of expenses to the inane inquiry, “Was the \$1,500 Toyota Celica sold?”

# Audit Tips and Best Practices

- Submission of supplemental information without prior notice will generally raise the profile of a return and increase the likelihood of audit, well-intentioned or not
- Do not hesitate to push back on examiner challenges, when appropriate
- Arm yourself with cases that support expenses of administration taken as deductions
  - Ex: State supreme court case supported that executor was entitled to expend estate funds for reasonable maintenance and carrying charges of real property for a reasonable period of time (including taxes, fire insurance, certain repairs, telephone service, services of a caretaker, and lawn and garden care over a 4year period)
- With ETAs' numerous inventories and time-constraints, they may not always be aware of specific state law precedents which control in such a situations

# Audit Tips and Best Practices

- Be creative in finding non-legal authority to support your arguments
- It is said that litigation over a contract dispute sometimes provides a roadmap to more artfully structuring future contracts. Recognize that this maxim applies to audit challenges as guidelines for drafting future wills and trusts as well
  - Tax apportionment
  - Marital trust funding
  - Lifetime gifts

# Adequate Disclosure

- Reporting gratuitous transfers of assets to family members or trusts will trigger the 3 - year SOL if adequately disclosed
- **IRC § 6501(e)(2)** - General exception to SOL for estate/ gift taxes
- **CFR § 301.6501(c)-1(f)(2)** - Gifts
- **CFR § 301.6501(c)-1(f)(4)** - Non-gift completed transfers
- **CFR § 301.6501(c)-1(e)** - Transfer of property subject to special valuation rules under IRC §§ 2701 and 2702

# General Requirements

- 1) Description of transferred property and any consideration received by TP
- 2) Identity of and relationship between TP and donee
- 3) If trust, TIN and either brief description of trust terms or copy of trust agreement
- 4) Statement describing any contrary position taken
- 5) Either (see CFR§ 301.6501(c)-1(f) for details):
  - a) A detailed description of the method used to determine the FMV (including financial data, restrictions, and any discounts taken)
  - b) An appraisal by experienced appraiser who is not related/affiliated to TP



# Special Valuation Rules

- Applies to gifts of interests in a corporation, partnership, LLC, or trust fbo TP's family
- Additional requirements:
  - Description of transaction, including transferred and retained interests and methods of valuation
  - Identity and relationship of all participants, including parties related to TP who hold equity interest in any related entity
  - Description of entity's financial data used (balance sheets, statement of net earnings, operating results, dividends paid)

# Defined Value Clauses

- Defines amount of gifted property by reference to a specific dollar amount or formula
- Structured so that the transferor does not technically transfer a specific asset, percentage interest, or number of shares
  - Rather, defined value clause defines a dollar amount worth of the asset, interest, or shares
  - That dollar amount is typically translated into specific property following the initial transaction, preferably without input from the transferor
- Tip - Ensure all documentation (gift tax return, entity return, operating agreement, etc.) consistently references a dollar amount defined value

# Sample Language of Defined Value Clause

“A gift of that percentage assignee interest in XYZ, LLC, a Virginia limited liability company, with the fair market value equal to \$10,000,000, as finally determined for federal transfer tax purposes, represented by the Transferred Interest\*, as defined in the attached Assignment, dated December 31, 2021. As per the attached appraisal prepared by Joe Shmoe of a 1% membership interest in XYZ, LLC, the percentage of membership interest in XYZ, LLC reflecting this gift is \_\_\_\_%.”

\*The term “Transferred Interest” would be defined on a formula basis, in the assignment document effectuating the gift

# Examples in Recent Cases

- *Estate of Sanders v. Comm'r* T.C. Memo 2014-100
  - Decedent made gifts of stock to children and disclosed on gift tax returns
  - Statements attached to returns did not adequately disclose ownership of another closely held entity
  - Thus, SOL not triggered and gift tax assessed
- *Estate of Hughes v. Comm'r* T.C. Memo 2015-89
  - Decedent made multiple gifts of stock to wife, failing to report in one year and filing late another year (filed himself)
  - Court held that no evidence was provided to suggest that decedent reasonably relied upon professional advice, misunderstood fact or law, or had a reasonable basis for positions taken on return
  - Thus, not valid defense to gross misstatement

# Adequate Disclosure Tips and Best Practices

- Disclose, even if no gift tax will be owed
  - Err on providing more information
  - Strict adherence to requirements
- Obtain appraisal with valuation date on date of transfer or closest as possible
  - No rule for gift tax purposes
  - For income tax purposes, appraisals required for charitable gifts >\$5,000 made no earlier than 60 days prior to contribution date
- If gift-splitting between spouses, file gift tax returns together under single letter with disclosure exhibits on donor's return only

# Questions?

# Contact Information

Ken N. Jefferson  
Associate  
Ivins, Phillips & Barker  
kjefferson@ipbtax.com  
(202) 662-3430  
www.ipbtax.com



**Ivins Phillips Barker**  
CHARTERED

Chelsea L. McGrath  
Associate  
Venable LLP  
clmcgrath@venable.com  
(202) 344-4049  
www.venable.com

**VENABLE** LLP