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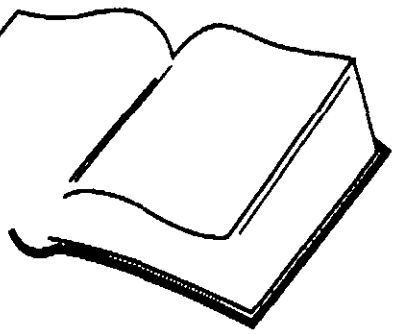

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Guidance Finally Provided for Carryover Basis and Election Out of the Estate Tax for 2010 Decedents

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The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312 (124 Stat. 3296), allows the executor of the estate of a 2010 decedent to elect to have the estate tax not apply to the estate and instead to subject the decedent's assets to modified carryover basis rules primarily contained in section 1022, instead of the estate tax value basis rules of section 1014. Practitioners have known since December 17, 2010 that this option would exist, but they have not until August 6, 2011 known when and how the election (the "Section 1022 Election") was required to be made. See the discussions in the January and February 2011 issues of the REPORTER. On that date, the Service issued *Revenue Procedure 2011-41*, 2011-35 I.R.B.188, providing detailed analysis of the carryover basis rules applicable to an estate making the Section 1022 Election, and *Notice 2011-66*, 2011-35 I.R.B. 184, providing detailed rules for making the Section 1022 Election.

Revenue Procedure 2011-41 Explains the Modified Carryover Basis Rules

Revenue Procedure 2011-41 provides detailed guidance for the modified carryover basis rules that applies if a Section 1022 Election is made. Executors contemplating a Section 1022 Election must determine both the date-of-death fair market value

and the decedent's adjusted basis in all assets passing on account of his or her death, and then determine how to allocate the various basis increases (the "Basis Increases") allowed under section 1022. Where the modified carryover basis rules apply, the basis in the hands of a recipient of property acquired from the decedent will be the lesser of the fair market value of the property on the date of death or the decedent's basis on the date of death increased by the allocated Basis Increases. In no event may Basis Increases be allocated to increase the adjusted basis of an asset above its fair market value on the date of the decedent's death.

Property Acquired From the Decedent. Revenue Procedure 2011-41 states that, if a Section 1022 Election is made, the modified carryover basis rules determine a recipient's basis in all property acquired from that decedent, regardless of the year in which the property is sold or distributed. Thus, an executor may allocate Basis Increases to property that has already been distributed or sold. *Rev. Proc. 2011-41* § 4.01(1). Practitioners should generally favor allocating Basis Increases to assets that have been sold soon after the date of death, to obtain early advantage of the Basis Increases.

The modified carryover basis rules apply only to property "acquired from the decedent," which includes:

(1) property acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent;

(2) property transferred by the decedent during his or her lifetime to a qualified revocable trust as defined in section 645(b)(1), regardless of whether the section 645 election is made;

(3) property transferred by the decedent during his or her lifetime to a trust that is not a qualified revocable trust, but with respect to which the decedent reserved the right to make any change in the enjoyment of the trust through the exercise of a power to alter, amend, or terminate the trust (including a retained reversionary interest in the trust on death or a retained power of appointment), such as powers described in sections 2036(a)(2) or 2038(a); and

(4) any other property that passes without consideration from the decedent by reason of his or her death, such as any property transferred at the decedent's death subject to the exercise or lapse of a general power of appointment not created by the decedent, property held by the decedent and another person as joint tenants with right of survivorship or as tenants by the entirety, and a surviving spouse's one-half interest in

community property. *Rev. Proc. 2011-41* § 4.01(4).

Property acquired from the decedent does not, however, include:

(1) items of income in respect of a decedent (IRD), which for this purpose, includes annuities subject to income tax under section 72. I.R.C. § 1022(f); *Rev. Rul. 2005-30*, 2005-1 C.B. 1015; *Rev. Proc. 2011-41* § 4.01(2);

(2) a decedent's interest in a qualified terminable interest property (QTIP) trust or similar arrangement funded for the benefit of the decedent by the decedent's predeceased spouse. *Rev. Proc. 2011-41* § 4.01(4). The income tax treatment of assets with an adjusted basis higher than their fair market value on the date of decedent's death, that are held by a QTIP trust created by the decedent's predeceasing spouse, is more favorable under the modified carryover basis rules than under the estate tax value basis rules. Under the modified carryover basis rules, the built-in loss is not forfeited because the assets are not property acquired from a decedent; under the estate tax value basis rules, the adjusted basis in the assets is decreased to their fair market value, eliminating any deductible loss; and

(3) trusts in which the decedent has retained a beneficial interest and that would be includable in the gross estate under 2036(a)(1). *Rev. Proc. 2011-41* § 4.06, Ex. 14.

Property to Which Basis Increase May Be Allocated. The aggregate basis increase and the spousal property basis increase (together, the "Basis Increase") can be allocated only to property that was "owned by the decedent at the time of death." I.R.C. § 1022(d)(1)(A). Property that was acquired from the decedent is not necessarily also owned by the decedent at death. Such assets take a modified carryover basis, but cannot be the subject of a valid allocation of Basis Increase.

Property owned by the decedent at death includes:

(1) property legally titled in the name of the decedent at death (and not held by the decedent solely in a legal or representative capacity);

(2) property owned jointly, whether as tenants in common or with rights of survivorship (see I.R.C. § 1022(d)(1)(B)(I));

(3) property transferred by the decedent during life to a qualified revocable trust as defined in section 645(b)(1), regardless of whether the section 645 election is made;

(4) certain community property (see section 1022(d)(1)(B)(iv)). *Rev. Proc. 2011-41* § 4.01(4); and

(5) property of a trust that would not otherwise be deemed to be owned by the decedent, but the trust requires that the trust property revert back to the decedent upon death, such as property in a GRAT or QPRT that reverts to the grantor or the grantor's estate upon his or her death. *Rev. Proc. 2011-41* § 4.01(4), Ex. 2.

Property owned by the decedent at death does not include:

(1) property over which the decedent holds any power of appointment;

(2) property transferred to a trust by the decedent during life, over which the decedent retained

a power to alter, amend, or terminate the trust, but not a power to revoke the trust. Such trusts are not qualified revocable trusts under section 645 because the decedent has no power to revest the assets in himself or herself, as defined in section 676. See Treas. Reg. § 1.676(a)-1;

(3) property transferred to a trust by the decedent during life over which the decedent retained an income interest;

(4) property transferred to a foreign trust by a United States grantor, even if the grantor owns the trust for income tax purposes under section 679; or

(5) an interest in a QTIP trust or similar arrangement created for the decedent's benefit by a predeceased spouse. *Rev. Proc. 2011-41* § 4.01(4).

Basis Increase also may not be allocated to property that is acquired by the decedent in a lifetime transfer for less than adequate and full consideration in money or money's worth during the three-year period ending on the date of the decedent's death, even though that property is both owned by and acquired from the decedent. I.R.C. § 1022(d)(1)(C). This prohibition does not apply to property acquired by the decedent from his or her spouse, if the property was not transferred to the spouse during such three-year period in whole or in part by inter vivos transfer for less than adequate and full consideration in money or money's worth. *Rev. Proc. 2011-41* § 4.01(5). If someone other than the decedent's spouse gave property to the decedent within three years of the decedent's death, therefore, Basis Increase may not be allocated to that property. If the decedent's spouse gave property to the decedent within three years of the decedent's death, Basis Increase may be allocated to the property, unless the spouse had received it as a gift from someone else during that same three-year period.

Basis Increase also may not be allocated to the stock or securities of a foreign personal holding company, a DISC (Domestic International Sales Corporation) or former DISC, a foreign investment company, or a passive foreign investment company, unless such company is a qualified electing fund as defined in section 1295 with respect to the decedent, despite the fact that such property is owned by and acquired from the decedent. I.R.C. § 1022(d)(1)(D). *Rev. Proc. 2011-41* § 4.01(5).

Determining the Basis Increase. The Basis Increase consists of the sum of the "General Basis Increase" ($1.3 million "Aggregate Basis Increase" plus the "Carryovers/Unrealized Losses Increase") and the $3 million "Spousal Property Basis Increase." I.R.C. §§ 1022(b), 1022(c).

The Carryovers/Unrealized Losses Increase consists of the sum of:

(1) the amount of any capital loss carryovers under section 1212(b) that would, but for the decedent's death, have been carried forward from the decedent's last taxable year to a later taxable year;

(2) the amount of any net operating loss carryovers under section 172 that would, but for the decedent's death, have been carried forward from the decedent's last taxable year to a later taxable year; and

(3) the amount of unrealized losses that would have been allowable under section 165, had the property acquired from the decedent been sold at fair market value immediately before the decedent's death. I.R.C. § 1022(b)(2)(C). Section 165(c)(3) losses — casualty and theft

losses on nonbusiness and noninvestment property — would not arise on a hypothetical sale of the property, and so any such actual losses must be claimed on the decedent's final income tax return, rather than being included in the Carryovers/Unrealized Losses Increase. *Rev. Proc. 2011-41* § 4.02(2)(b).

The capital loss deduction limitations, such as the $3,000 annual limitation for the deduction against ordinary income of net long-term capital losses of an individual, are ignored in computing unrealized losses for purposes of the Carryovers/Unrealized Losses Increase. I.R.C. § 1022(b)(2)(C)(ii); *Rev. Proc. 2011-41* § 4.02(2)(b), Ex. 3.

If the decedent's final Form 1040 is filed jointly with the decedent's surviving spouse, existing income tax rules determine the decedent's share of loss carryovers and unrealized losses under sections 172 and 1212(b). Thus, for example, a calendar year decedent and surviving spouse who file a joint tax return for 2010 determine these amounts based on their relative tax liability in the decedent's final taxable year ending on the date of the decedent's death and the surviving spouse's taxable year ending on December 31, 2010. *Rev. Proc. 2011-41* § 4.02(2)(b).

The Spousal Property Basis Increase may be allocated only to "qualified spousal property" owned by and acquired from the decedent. Qualified spousal property must be transferred either outright to the decedent's surviving spouse or as qualifying terminable interest property (QTIP), as defined for federal estate tax purposes, whether or not held in trust. This should not mean that the Spousal Property Basis Increase cannot be allocated to property passing to a general power of appointment marital deduction trust because such a trust also meets the requirements of a QTIP for federal estate tax purposes.

The executor may allocate Spousal Property Basis Increase to qualified spousal property that has already been distributed or that is sold before its distribution, whether the allocation is made before or after the sale. *Rev. Proc. 2011-41* § 4.02(3). The allocation of Spousal Property Basis Increase to property that the estate has already sold is permitted, even if it would produce a net loss on the sale. However, the allocation cannot increase the adjusted basis above the asset's fair market value on the date of death. *Rev. Proc. 2011-41* § 4.02(3), Ex. 4. (The Revenue Procedure does not so state, but the same rule should logically also apply to allocation of the Aggregate Basis Increase.)

The Spousal Property Basis Increase may be allocated only if the executor:

(1) certifies on Form 8939 that the net proceeds from the sale of that property will be distributed to or for the benefit of the decedent's surviving spouse in a manner that would qualify property as qualified spousal property; and

(2) attaches to Form 8939 (discussed below) each document providing a bequest or devise to the surviving spouse.

The executor cannot allocate the Spousal Property Basis Increase to any portion of the assets, or the proceeds of the disposition of the assets, that are themselves not distributed to the surviving spouse. Thus, the Spousal Property Basis Increase cannot be allocated to assets that are left to the surviving spouse, if the executor sells them and applies the proceeds to pay administrative expenses or taxes. *Rev. Proc. 2011-41* § 4.02(3), Exs. 5 and 6.

The Spousal Property Basis Increase may be allocated to property held by a qualified testamentary charitable remainder trust, if the surviving spouse is

the sole non-charitable beneficiary and the trust would have qualified for the estate tax marital deduction if the Section 1022 Election not been made. I.R.C. § 2056(b)(8); *Rev. Proc. 2011-41* § 4.02(3).

Nonresident Aliens. U.S. assets owned by a nonresident alien decedent may receive a $60,000 Aggregate Basis Increase, but no Carryovers/Unrealized Losses Increase. I.R.C. § 1022(b)(3). The executor of the U.S. estate of a nonresident alien decedent may also allocate the $3 million Spousal Property Basis Increase to qualified spousal property owned by and acquired from the decedent. *Rev. Proc. 2011-41* § 4.02(4).

How to Allocate Basis Increase. The executor has very broad authority over the manner in which the Basis Increase is allocated among the assets owned by and acquired from the decedent. The Basis Increase must be allocated on a property-by-property basis, but it may be allocated to one or more shares of stock or to a particular block of stock, rather than to the decedent's entire holding of that stock. Basis Increase may be allocated to property even after the executor has disposed of or distributed the property. An executor may not, however, allocate more Basis Increase to an asset than will be needed to raise its adjusted basis to its fair market value on the date of death. I.R.C. § 1022(d)(2); *Rev. Proc. 2011-41* § 4.03.

The executor may allocate Basis Increase to an interest in property owned by the decedent, such as a life estate or remainder interest. If the decedent's death results in the division of the decedent's property into different interests, other than undivided portions or fractional interests of each and every interest or right in the property that was owned by the decedent, Basis Increase may not be allocated separately to the various interests in that property created by reason of the decedent's death. Thus, if the decedent leaves property to A for life, with the remainder to B, Basis Increase may be allocated to the property owned by the decedent at death, but not separately to A's life estate or to B's remainder interest. *Rev. Proc. 2011-41* § 4.03.

The executor of the estate of a decedent who leaves property in shares to multiple persons, whether or not the property is easily severable, can allocate Basis Increase among shares disproportionately, as long as the allocation is made to undivided portions or fractional interests of each and every interest or right in the property. For example, if D leaves Blackacre equally to A, B, and C, D's executor could allocate the General Basis Increase entirely to the shares passing to A and B and allocate none of the General Basis Increase to the shares passing to C.

The Notice does not address whether one can allocate Basis Increase to improvements, while not allocating it to the land on which the improvements sit, when the decedent owned both the land and the improvements. Allocating Basis Increase to the improvements would be highly desirable because the improvements are depreciable. Perhaps later guidance will be provided to deal with this issue, though it seems unlikely to be forthcoming before the required filing date for Form 8939.

Determining Fair Market Value. The fair market value of property for modified carryover basis purposes is determined in the same fashion as it would have been for estate tax purposes. The executor must attach the appraisals required under the estate tax rules to Form 706. *Rev. Proc. 2011-41* § 4.04(1).

The fair market value of an undivided portion of the decedent's property that is acquired from the decedent at death is deemed to be a fractional share of the total fair market value of the decedent's property

at death, without any discounts or premiums that were not used to determine the value of the decedent's own interest. *Rev. Proc. 2011-41* § 4.04(2). Thus, if the decedent leaves Blackacre, worth $1 million at his or her death, equally to A and B as tenants-in-common, the value of their interests, as a cap on the Basis Increase allocation, is $500,000 each, without regard to the fact that tenancy-in-common interests are usually significantly less marketable than interests held in one's sole name. This rule is favorable because it increases the value of each share of the property for purposes of Basis Increase allocation, and thereby permits a greater allocation of Basis Increase to each share.

Community Property. Both the decedent's interest and the spouse's interest in community property owned by them on the date of the decedent's death are treated as property owned by and acquired from the decedent. I.R.C. § 1022(d)(1)(B)(iv); *Rev. Proc. 2011-41* § 4.05. Therefore, the surviving spouse's basis in his or her one-half interest in community property will be adjusted on the decedent's death to the lesser of the surviving spouse's own adjusted basis or the fair market value of that interest on the decedent's date of death. Basis Increase may be allocated to the surviving spouse's one-half interest in community property. *Rev. Proc. 2011-41* § 4.05, Ex. 7.

All of the unrealized losses that would have been allowable to both the decedent and the surviving spouse, had the property been sold at fair market value immediately before the decedent's death, are included in the General Basis Increase. Only the decedent's own net operating loss carryovers and capital loss carryovers, however, are included in the General Basis Increase. The decedent's net operating loss carryovers and capital loss carryovers that are deductible on the final jointly filed Form 1040 are not added to the General Basis Increase. *Rev. Proc. 2011-41* § 4.05.

Holding Period. The holding period of a recipient's property, the basis of which is determined under the modified carryover basis rules, includes the decedent's holding period, even if the executor allocates sufficient Basis Increase to the property to give it a basis equal to its fair market value on the date of death. The applicable percentage determination for purposes of the depreciation recapture rules of section 1250, which adjusts the amount of potential recapture based on the length of the taxpayer's holding period, is calculated under the recapture rules applicable to acquisitions by gift. The recipient's holding period in property with the basis determined under the modified carryover basis rules, therefore, includes the decedent's holding period, regardless of whether the executor allocates Basis Increase to that property. *Rev. Proc. 2011-41* §4.06(1).

Tax Character of Property. The tax character of property acquired from the decedent by a recipient (such as whether it is an investment asset or inventory) is determined in the same way as its holding period. Thus, to the extent a recipient's basis in property is determined under the modified carryover basis rules, the tax character of the property is the same as it would have been in the hands of the decedent. For example, depreciable tangible personal property of a decedent that passes to a beneficiary who holds it for nonbusiness purposes remains subject to the ordinary income recapture rules of section 1245. *Rev. Proc. 2011-41* § 4.06(2), Ex. 9.

Depreciation of Property Acquired from the Decedent. The recipient of property that was depreciated by the decedent is bound by the decedent's depreciation method, recovery period, and conventions for that portion of the recipient's basis in the property that equals the decedent's adjusted basis in the property. The allowable depreciation deduction for 2010 for property that is depreciable in the hands

of both the decedent and the recipient during 2010 is allocated between them on a monthly basis. See Treas. Reg. § 1.168(d)-1(b)(7)(ii). The portion of the recipient's basis in the property that exceeds the decedent's adjusted basis on the date of death, including any Basis Increase allocated to the property, is treated for depreciation purposes as a separate asset placed in service on the date of the decedent's death. *Rev. Proc. 2011-41* § 4.06(3).

Passive Activity Losses. An interest in a passive activity that is transferred at the death of a 2010 decedent whose executor makes a valid Section 1022 Election is determined under the rules for transfers of interests by gift. The basis of such interest immediately before the transfer, therefore, is increased by the amount of any passive activity losses allocable to the interest that have not been allowed as deductions as a result of section 469(a). These losses cannot be deducted for any taxable year. The basis adjustment under section 469(j)(6) is deemed to occur immediately before the decedent's death and is applied to determine the decedent's adjusted basis in the property at death for purposes of the modified carryover basis rules. Any loss that would have been sustained under sections 165(c)(1) or 165(c)(2) on a hypothetical sale of the property immediately before the decedent's death may be included as section 165 losses in the General Basis Increase. Because the reduction in the hypothetical loss under section 165 by reason of the section 469 basis adjustment equals the amount of passive activity loss added to the decedent's basis, the Service concluded that there is no duplication of a benefit under these two sections. *Rev. Proc. 2011-41* § 4.06(4), Ex. 10.

All of the suspended passive activity losses allocable to both spouses' interest in community property are used to determine the decedent and spouse's adjusted basis in the community property under the modified carryover basis rules and to determine the amount of unrealized section 165 losses included in the General Basis Increase. Passive losses that are used to increase basis and/or to increase the General Basis Increase may not thereafter be deducted by the surviving spouse. Losses attributable to the surviving spouse's interest in community property that are not so used by the decedent's executor remain the surviving spouse's own suspended passive activity losses. *Rev. Proc. 2011-41* § 4.06(4), Ex. 11.

Satisfaction of Pecuniary Bequest with Appreciated Property. Section 1040 states that an estate that distributes appreciated carryover basis property to satisfy a pecuniary bequest must recognize gain only to the extent of the post mortem increase in the value of the asset. The same rule is applied to distributions of appreciated trust property made in satisfaction of trust provisions that are the equivalent of a pecuniary bequest, but only to the extent so provided in regulations. The Revenue Procedure creates a safe harbor for distributions from a qualified revocable trust, as defined in section 645(b)(1), and from trusts that would have been included in the decedent's gross estate for federal estate tax purposes under sections 2036, 2037, or 2038, had the decedent's executor not made the Section 1022 Election. Section 1040 does not apply to the distribution of property that constitutes an item of IRD. *Rev. Proc. 2011-41* § 4.06(5).

Transfers to Foreign Estates and Foreign Nongrantor Trusts. Section 684 states that any transfer of appreciated property by a U.S. person to a foreign estate or nongrantor trust is treated as a sale or exchange on which the transferor recognizes gain. This provision also applies to transfers of property occurring on the 2010 death of a decedent whose executor makes the Section 1022 Election. The Regulations make an exception for transfers of

property by reason of the death of a U.S. person, if the basis of the property in the hands of the recipient is determined under the estate-tax-value basis rules of section 1014(a). Treas. Reg. § 1.684-3(c). *Revenue Procedure 2011-41* states that, if property is owned by and acquired from a U.S. decedent dying in 2010, the executor's allocation of Basis Increase will be deemed to occur before the application of section 684, thus reducing or eliminating recognition of gain under section 684.

Testamentary Charitable Remainder Trusts. The Service stated that a testamentary charitable remainder trust that is otherwise qualified, but that fails to meet the requirement that a deduction is allowable under section 2055 solely because the decedent's executor makes a Section 1022 Election, will still be a qualified charitable remainder trust. *Rev. Proc. 2011-41* § 4.07.

Effective Date. This revenue procedure is effective August 29, 2011, the date this revenue procedure was published in the Internal Revenue Bulletin. Taxpayers may apply the safe harbor rule in the revenue procedure for prior periods, however.

Notice 2011-66 Provides Guidance for Electing Out of the Estate Tax

Notice 2011-66 provides detailed guidance regarding how and when to make the Section 1022 Election, and how to make other GST tax elections and allocations that may be needed by an executor who is not filing an estate tax return for a 2010 decedent.

How to Make the Election. The executor of the estate of a 2010 decedent can elect out of the estate tax by filing a Form 8939, "Allocation of Increase in Basis for Property Acquired From a Decedent." This form has not yet been released, but the press release accompanying *Notice 2011-66* states that it will be published "early this fall". *Inf. Rel. 2011-83* (Aug. 5, 2011); *Notice 2011-66* § I.A. This gives practitioners somewhat less than the 90 days previously promised (see the discussion below).

An executor who is unsure on September 19, 2011 whether to file an estate tax return or a Form 8939 should request an extension of the time to file the estate tax return (Form 706 or 706NA), which will allow the executor until November 15 to make a final decision.

An executor cannot validly file both an estate tax return and a Form 8939 for a 2010 decedent — the executor must file one or the other. The Service will, if it receives both a Form 8939 and an estate tax return for the same decedent, issue a letter to each person who filed one of the forms, notifying them of the conflict, providing the name and address of each other person who filed a form, and explaining that they must all collectively sign and file either a restated estate tax return or a restated Form 8939 within 90 days from the date the Service mails the letters. This procedure is cumbersome and likely to put serious time pressures on those involved. Persons who have possession of only part of a decedent's assets and data should work together to file a complete Form 8939 or estate tax return initially.

If no restated form is filed within the 90-day period, the Service will determine whether the executor has made a Section 1022 Election or the estate remains subject to the estate tax, considering all relevant facts and circumstances disclosed to the Service, including (but not limited to) the relative total fair market values of the decedent's property in the executor's possession and the nature and significance of the economic impact of the Section 1022 Election (or its loss) on the beneficial owners of the property held by each executor. The Service stated that some factors may be more relevant, and may be accorded more weight than others for any

particular estate, but it does not explain how it will weigh various factors or whether it will seek to maximize revenue. *Notice 2011-66* § I.A. Practitioners should note that it is not the Service's job to minimize taxes, and it may not do so if the parties fail to make a correct Section 1022 Election.

Allocating the Basis Increase. The executor must allocate the Basis Increase on a timely filed Form 8939. Section 2203 states that, for this purpose, someone who is appointed, qualified, and acting for a decedent's U.S. estate will be the executor and the Service generally will accept only Section 1022 Elections filed by that person. That executor must, however, report on Form 8939 both the probate and nonprobate assets, even if the executor does not have possession of those assets. This is a serious burden, but it is no different than that imposed on executors filing traditional estate tax returns.

If there is no appointed executor or administrator, each person in actual or constructive possession of property acquired from the decedent may file a Form 8939 and allocate Basis Increase for the property he or she actually or constructively possesses. The Notice does not state what happens if one or more persons in possession of property fail to file Form 8939. Those *persons who do not file the form should certainly be* liable for a $10,000 penalty under section 6716(a) for failure to file, though the persons who do file should not be subject to any penalties merely because some of the other persons fail to file.

The Service will, if it receives multiple Forms 8939 that collectively purport to allocate more Basis Increase than is legally available, issue a letter to each person who filed such a form, informing them of the name and address of each other person who filed a Form 8939 for that decedent, and explaining that each of them must collectively sign and file a single, restated Form 8939 allocating available Basis Increase to make a Section 1022 Election. The restated Form 8939 must be filed within 90 days from the date the Service mails such letters.

If no timely, signed and restated Form 8939 is filed, the Service will allocate the available Basis Increase as it, in its discretion, may determine, considering all relevant facts and circumstances disclosed to the Service. The Notice states that the allocation might be made on a pro-rata basis, based on the amount of unrecognized appreciation in the property owned by the decedent at death that was reported on the timely filed Forms 8939, or in any other manner deemed appropriate for the particular decedent's estate by the Service in the exercise of its discretion. *Notice 2011-66* § I.B. Again, practitioners should note that it is not the Service's job to minimize the taxpayer's income tax liabilities, and it is unlikely that a Basis Increase allocation prepared by the Service will be as favorable as one prepared by the fiduciaries acting with the advice of competent counsel.

The recipient's basis in a particular property (including the amount of Basis Increase allocated to that property) is subject to adjustment upon the examination by the Service of any tax return reporting *a value dependent upon the property's basis — for* example, the property's depreciation, sale, or *other* disposition that triggers gain or loss on the property, or otherwise. *Notice 2011-66* § I.B.

Reporting Requirements. An executor making a Section 1022 Election must report on Form 8939 the value of all of the property (excluding cash and property that constitutes the right to receive an item of IRD) acquired from the decedent. I.R.C. § 6018(b)(1). The executor must also report all appreciated property acquired from the decedent, valued as of the decedent's date of death, that was required to be included on a donor's gift tax return

(Form 709), if the property was acquired by the decedent by inter vivos transfer for less than adequate and full consideration in money or money's worth during the three-year period ending on the date of the decedent's death. I.R.C. § 6018(b)(2). This does not include property transferred to the decedent by the decedent's spouse, unless the spouse acquired the property in whole or in part by inter vivos transfer for less than adequate and full consideration in money or money's worth during that same three-year period. *Notice 2011-66* § I.C.

The executor of the U.S. estate of a nonresident alien decedent needs only report property acquired from the decedent by a U.S. person and tangible property situated in the United States that is acquired from the decedent, whether or not acquired by a U.S. person. *Notice 2011-66* § I.C.

Within 30 days after filing a timely Form 8939, the executor must provide to each recipient acquiring property reported on Form 8939 a statement setting forth the information required under section 6018(c), whether or not Basis Increase is allocated to such property. If there are multiple executors, each must file this statement. *Notice 2011-66* § I.C. The executor must also provide updated statements to each recipient of property reported on Form 8939, if an adjustment is made to the basis. This updated statement must be filed within 30 days after making the adjustment or receiving notice of the adjustment from the Service, whichever is applicable. *Notice 2011-66* § I.C.

When to File Form 8939. Form 8939 is generally due November 15, 2011. Once made, the Section 1022 Election is irrevocable, except as provided later in the notice, and any prior filing that purported to be a Section 1022 Election must be replaced by a Form 8939. *Notice 2011-66* § I.A.

A Form 8939 filed before November 15, 2011 may be amended or revoked on another Form 8939 filed on or before November 15, 2011. A Form 8939 filed by one executor will have no effect on a Form 8939 filed by a different executor. *Notice 2011-66* § I.D.1.

The Service will not grant extensions of time to file a Form 8939 and will not accept a Form 8939 or an amended Form 8939 filed after November 15, 2011, except in the event of conflicting filings or in certain relief situations described below. Thus, an executor cannot file both an estate tax return and a conditional Form 8939 that would be effective only if an estate tax audit results in an increase in the gross estate above the applicable exclusion amount. *Notice 2011-66* § I.D.2. Similarly, an executor who believes that his or her estate will be below $5 million cannot file a Form 8939 that would be applicable only if the taxable estate were determined to be above $5 million.

Persons qualifying under section 7508 (persons serving the military in a combat zone or contingency operation) or section 7508A (cases involving Presidentially-declared disaster or terroristic or military actions) are eligible to file a Form 8939 after November 15, 2011, as provided in those sections. An executor filing a Form 8939 after November 15, 2011 pursuant to these sections should write "Filed Pursuant to Section 7508" or "Filed Pursuant to Section 7508A," as applicable, on the top of the form, though the extension applies even if the executor fails to write these notations at the top of the form. The executor for a decedent who qualifies for relief under section 692 (members of Armed Forces, astronauts, and victims of certain terrorist attacks on death) must file a Form 8939 to make the Section 1022 Election. *Notice 2011-66* § I.D.1.

Relief from the filing requirements for Form 8939 is available in four situations. First, an amended

Form 8939 may be filed after November 15, 2011, solely to allocate the Spousal Property Basis Increase among the eligible property, if (1) the Form 8939 was timely filed and was otherwise complete when filed, and (2) the amended Form 8939 is filed no more than 90 days after the date of the distribution of the qualified spousal property to which Spousal Property Basis Increase is allocated on that amended Form 8939. *Notice 2011-66* § I.D.2.

Second, an executor who timely files a Form 8939 may file an amended Form 8939 on or before May 15, 2012 (six months after November 15), if relief is obtained under Regulations section 301.9100-2(b). This regulation allows an additional six months in which to file or amend a return that was itself timely-filed, if the taxpayer takes corrective action to file an original or amended return that should have been made "and attach[es] the appropriate form or statement for making the election." No request for letter ruling is required. This amendment cannot be used to revoke a Section 1022 Election, and the executor must write "Filed Pursuant to Section 301.9100-2" on the top of the amended Form 8939. *Notice 2011-66* § I.D.2. This exception might be useful for correcting a failure to allocate GST exemption, as discussed below.

Third, an executor may ask for relief under Regulations section 301.9100-3 (a private letter ruling request establishing to the satisfaction of the Service that the taxpayer acted reasonably and in good faith, if the grant of relief will not prejudice the interests of the Government) to supplement a timely filed Form 8939 to extend the time to allocate any Basis Increase that has not previously been validly allocated. This relief may be granted if (1) after filing the Form 8939, the executor discovers additional property to which remaining Basis Increase could be allocated, and/or (2) the fair market value of property reported on the Form 8939 is adjusted as the result of an Service examination or inquiry. Relief will not be granted to reduce an allocation of Basis Increase made on a timely filed Form 8939. *Notice 2011-66* § I.D.2. This relief does not appear to be available to change an allocation other than because of after-discovered assets or adjustments in value due to a Service examination or inquiry.

Fourth, an executor may apply for relief under Regulations section 301.9100-3 to extend the time to file Form 8939 to make the Section 1022 Election and allocate Basis Increase. In this context, however, the Service states that the amount of time that has elapsed since the decedent's death may constitute a lack of reasonableness and good faith and/or prejudice to the interests of the government — for example, the use of hindsight to achieve a more favorable tax result and/or the lack of records available to establish what property was or was not owned by the decedent at death — which would prevent the grant of the requested relief. *Notice 2011-66* § I.D.2.

Probably the most important point made by the Notice regarding the filing date of Form 8939 is that the return due date is inflexibly set at November 15, 2011. Extensions will be granted only in a very few special situations. Previously, an IRS official, responding to comments about the IRS draft of Form 8939 made by the Tax Section and the Real Property, Probate and Trust Law Section of the American Bar Association, stated that practitioners would have at least 90 days between the publication of Form 8939 and the required filing date. Practitioners will actually be lucky to have 60 days between the release of the form and the filing date. Practitioners who have deferred all action on estates until this guidance was issued may be pressed for time. Those who have spent the past several months assembling the relevant data and obtaining the necessary appraisals will likely

have adequate time in which to prepare the necessary Forms 8939. Even well-prepared practitioners, however, should be sure to implement a careful system of ticklers to remind them of the relevant deadlines.

GST Tax in 2010. The GST tax was retroactively reinstated and applies to the estates of all decedents who died in 2010, even if a Section 1022 Election is made. See the discussion in the January 2011 issue of the REPORTER. The applicable rate for GST transfers in 2010 is zero, which the Service interprets to mean that the maximum federal estate tax rate for purposes of computing the GST tax on such a transfer is deemed to be zero. Therefore, the only way to achieve a zero inclusion ratio for a 2010 transfer is to allocate GST exemption to the transfer. *Notice 2011-66* § II.A.

An executor who makes the Section 1022 Election may allocate the decedent's available GST exemption by attaching the Schedule R of Form 8939 to the Form 8939 for that estate. If the Form 8939 is timely filed, the GST allocation will be considered timely made. *Notice 2011-66* § II.A. The Notice does not so state, but there is no reason to believe that the decedent's available GST exemption can be allocated only to assets passing from the decedent. The executor who files a Form 8939 should be able to allocate GST exemption to assets passing as a QTIP trust created by the decedent's predeceased spouse.

A donor of a 2010 inter vivos direct skip who wishes to pay GST tax at the applicable rate of zero percent should also want to avoid automatic allocation of GST exemption to the transfer because that exemption would be wasted. Such a donor may elect out of the automatic allocation of GST exemption to an outright inter vivos direct skip by filing a timely gift tax return (Form 709), describing both the transfer and the extent to which the automatic allocation is not to apply. The Service will interpret the reporting of an inter vivos direct skip not in trust occurring in 2010 on a timely filed gift tax return as constituting the payment of tax (at the rate of zero percent), which itself constitutes a valid election out of the automatic allocation of GST exemption to that direct skip. This interpretation also applies to a direct skip not in trust occurring at the close of an estate tax inclusion period (ETIP) in 2010, other than by reason of the donor's death. This interpretation does not extend to direct skips in trust, however, because a donor may reasonably not want to allocate GST exemption to a 2010 direct skip made to a trust. This interpretation will also not apply to either a direct skip or the closure of an ETIP occasioned by the donor's death in 2010. Treas. Reg. § 26.2632-1(c)(4). The rules regarding the automatic allocation of GST exemption will apply to transfers described in the preceding sentence unless the transferor affirmatively elects to have those rules not apply. *Notice 2011-66* § II.B.

A return reporting a direct skip, a taxable distribution, or a taxable termination (including any election required to be made on such return) that occurred after December 31, 2009 and before December 17, 2010 must be filed by September 19, 2011, including extensions. A Schedule R attached to a Form 8939, however, is still due on or before November 15, 2011. *Notice 2011-66* § II.C.

The due date of a return or portion of a return relating to an indirect skip or to a post-December 16, 2010 direct skip is not extended. The due date for filing a gift tax return reporting a transfer after December 17, 2010 and before January 1, 2011, reporting no GST transfer, was April 18, 2011, including extensions. Similarly, the due date for filing a gift tax return to elect to treat a trust as a GST trust, or to allocate GST exemption to a taxable termination or taxable distribution in 2010, was April

18, 2011, including extensions. *Notice 2011-66* § II.C.

A donor who timely filed a gift tax return for the taxable year ending December 31, 2010, but failed to allocate GST exemption to a transfer occurring in that year, however, may be eligible for section 9100 relief. *Notice 2011-66* § II.C.

Transfer Certificates. A transfer agent who holds property registered in the name of a nonresident alien decedent can usually avoid application of the ten-year estate tax lien under section 6324(a)(1) by obtaining a transfer certificate from the Service certifying that the estate has no estate tax liability. Treas. Reg. § 20.6325-1(a). The Notice states that no transfer certificate is required, and the Service will not issue transfer certificates, for the property of a nonresident decedent who is not a citizen of the United States, who died in 2010, and whose executor makes the Section 1022 Election. *Notice 2011-66* § III.

Section 645 Elections. The section 645 election to treat a qualified revocable trust as part of a decedent's estate, rather than as a separate entity, applies from the date of death until the "applicable date," which is defined as the date two years after the date of death, if no estate tax return is required to be filed. The Service explained that an estate that makes a Section 1022 Election will also have an applicable date that is two years after the date of the decedent's death. *Notice 2011-66* § IV.

Regulations Will Be Issued. The IRS promises to issue regulations to confirm the guidance in the Notice. The Notice will be good authority until the regulations are finalized.

Number of Returns. The Notice estimates that 7000 estates will file Form 8939 and that executors will need approximately ten hours to comply with the Form 8939 requirements. Oddly, *Revenue Procedure 2011-41* estimates that executors will need approximately eight hours "to prepare the documentation" on carryover basis. While one may not be interested in questioning the Service's estimate of the number of estates that will file Form 8939, the estimate of the time required to handle the Section 1022 Election appears dramatically low.

Retain Books and Records. "Books or records relating to collections of information must be retained as long as their contents may become material in the administration of any internal revenue law." Presumably, these records must be retained until all assets passing from the decedent have been sold by the recipients and the statute of limitations has run on the income tax returns reporting the gain transactions.

Conclusions

Calculating basis under the modified carryover basis rules and making the Section 1022 Election are only two of the many issues related to an election out of the estate tax for a 2010 decedent, as discussed in the February 2011 issue of the REPORTER. They are, however, important parts of this process, and practitioners should rejoice in the extensive and rather generous guidance provided in *Revenue Procedure 2011-41* and *Notice 2011-66.* But perhaps we should save our rejoicing until we see Form 8939 and its instructions, which are promised for release early this fall. If they are released early enough to provide an opportunity, they will be reviewed in the REPORTER.