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Selling the Family Business, Midland Business and Estate Council, Midland, Texas, September 2003
Educational Planning For Minors: Section 529 Plans, Trusts, and Others, Texas Society of Certified Public Accountants, Houston Chapter: 2003 CPE Family Conference, Galveston, Texas, June 2003
Educational Planning For Minors: Section 529 Plans, Trusts, and Others, Denton County Bar Association, Denton, Texas, February 2003
Estate Planning Overview, Immigration and Naturalization Service, Dallas, Texas, May 2002
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TO REPORT OR NOT TO REPORT: DUTY TO FILE SUPPLEMENTAL INFORMATION FOR FORM 706 AND AN UPDATE ON FORM 709

I. INTRODUCTION

If a client has filed a United States Estate (and Generation-Skipping Transfer) Tax Returns (“Form 706”) or the United States Gift (and Generation-Skipping) Tax Returns (“Form 709”) but subsequently learns that the return contained an error, what are her obligations? What are the attorney’s obligations in advising the client?

The vast majority of information and much paper and brain power has been spent analyzing when individuals and entities are required to amend their Federal income tax returns. Far less time has been spent to analyzing when and how to file supplemental information to a Form 706 or whether amended Form 706 or 709 can be filed and a client’s duties associated with such filings.

This article will review the guidelines for filing requirements for Forms 706 and 709, the statutory basis for filing Supplemental Information (or amended returns), the basis of the IRS' acceptance of “amended” returns, the duties to file supplemental information or amended returns and the applicable ethical obligations on attorneys advising clients on these issues.

Note: Unless stated otherwise, all references in this article to specific section references or the “Code” is to the Internal Revenue Code of 1986, as amended

II. FILING REQUIREMENTS; FORMS 706 AND 709

A. Who is Required to File?

1. Form 706

Section 6018(a)(1) provides that an estate tax return must be filed for a U.S. citizen (wherever resident) or U.S. resident if the gross estate exceeds the “applicable exclusion amount” in effect for the calendar year that includes the date of death. Section 6018(a)(2) provides that estate tax return must be filed for the estate of a nonresident alien if the date of death value of the part of the gross estate situated in the U.S. is more than the excess of $60,000 over the sum of (1) the amount of adjusted taxable gifts made by the decedent after '76, and (2) the amount of any pre-'1977 specific exemption allowed for gifts made by the decedent after September 8, 1976.

2. Form 709

Section 6019(a) provides that any individual who in any calendar year makes any transfer by gift other than (1) a transfer under Section 2503(b) ($11,000 per donee exclusion) or (e) (certain transfers for educational or medical expenses) shall not be included; (2) a transfer of an interest with respect to which a deduction is allowed under Section 2523 (gifts to spouse); or (3) certain transfers with which a deduction is allowed under Section 2522 (certain charitable gifts) shall make a gift tax return for such year.

B. When to File

1. Form 706

Section 6075(a) provides that Form 706 shall be filed within nine (9) months after the date of the decedent’s death.

2. Form 709

Section 6075(b) provides that Form 709 is due no later than April 15th of the year following the calendar year when the gifts were made.

C. Extensions

1. Form 706

a. Automatic

An estate is allowed an automatic six-month extension of time beyond the regular due date of the return to file Form 706 if an application on Form 4768 is filed on or before the due date for filing Form 706. Treas. Reg. §20.6081-1(b). Form 4768 must be filed with the IRS office designated in the instruction to Form 4768 and include an estimate of the amount of estate and GST tax liabilities with respect to the estate. Treas. Reg. §20.6081-1(a).

Treasury Regulation Section 20.6081-1(b) only provides an automatic extension for estates filing on Form 706. Therefore, for estates filing other IRS Forms (i.e., Form 706-A, Form 706-D, Form 706-NA and Form 706-QDT) the automatic extension is not available.

b. Discretionary Extensions

The IRS may, upon the showing of good and sufficient cause, grant a discretionary extension of time to file Form 706. A discretionary extension may be granted to (i) an estate that did not make a timely request for an automatic extension of time to file Form 706; (ii) an estate a person that is required to file a forms other than Form 706; or (iii) an executor who is abroad and is requesting an additional extension of time to file Form 706 beyond the six-month extension. Unless the executor is abroad, the discretionary extension of time may not be for more than six months beyond the regular filing date. Treas. Reg. §20.6081-1(c).

2. Form 709

a. General

As with Form 706, the IRS may extend the due date of Form 709 for a reasonable period of time, not to exceed six months for donors (or longer if the donor
is abroad). The extension application must be received before the expiration of the unextended time for filing the return. Treas. Reg. §25.6081-1.

b. Methods to Extend

There are two methods to extend the due date of Form 709. Any extension of time granted for filing a donor’s Federal income tax return will also extend the time to file the donor’s gift tax return. Income tax extensions are made by using Form 4868, 2688 or 2350, which have checkboxes for Form 709. A donor may only use these forms to extend the time for filing a gift tax return if also requesting an extension to file an income tax return. Alternatively, a donor can request an extension of time to file Form 709 by sending an explanatory letter to the IRS containing the reasons for delay. Instructions to Form 709 (2003), p. 4. A donor must use a letter to request an extension of time to file a gift tax return unless also requesting an extension to file an income tax return.

c. Form 709; Coordination with Form 706

Section 6075(b)(3) provides that the time for filing Form 709 for the calendar year which includes the date of death of the donor shall not be later than the time (including extensions) for filing Form 706 with respect to such donor.

III. FILING SUPPLEMENTAL INFORMATION

A. General

While the Code and Treasury Regulations do not provide an avenue allowing the filing of amended Forms 706 or 709, Treasury Regulations allow “supplemental information” to be filed for Form 706.

B. Treasury Regulations

Pursuant to the Treasury Regulations, Form 706 cannot be amended after the expiration of any extension period obtained for filing the return. However, supplemental information may later be filed that may result in a finally determined tax different from the amount shown as the tax on the return. Treas. Reg. §20.6081-1(d).

C. Instructions to Form 706

The Instructions to Form 706 provide that if an executor finds that he must change something on an estate tax return that has already been filed, the executor should file another Form 706 and write “Supplemental Information” across the top of page 1 of the form. If the executor has already been notified that the return has been selected for examination, he should provide the additional information directly to the IRS office conducting the examination. Instructions to Form 706, (8/2003), p. 2.

D. Form 709; No Guidance

No provision in either the Code, Treasury Regulations or Instructions to Form 709 provide for amending gift tax returns or submitting supplemental information to a previously filed Form 709.

IV. AMENDED RETURNS; STATUTORY BACKGROUND

A. “One Return” Concept

Section 6011(a) provides that “when required by regulations prescribed by the Secretary any person made liable for any tax imposed by this title, or for the collection thereof, shall made a return or statement according to forms and regulations prescribed by the Secretary” (emphasis added).

Commentators have noted that Section 6011 generally contemplates the filing of a single required return by a taxpayer. Saltzman, IRS Practice and Procedure ¶4.02[3] (1991); Harris, “On Requiring the Correction of Error Under the Federal Tax Law,” 42 Tax Lawyer 515, 516 (1989). While the vast analysis on the “one return” concept of Section 6011 is focused entirely on income tax returns, based upon the Code sections relied upon for this analysis, the same conclusions should also apply to Forms 706 and 709.

B. Amended Returns Not Required

To date, the Treasury has not issued regulations requiring the filing of amended returns. However, a few statutory provisions in the Code refer to amended returns. See, e.g., I.R.C. §§ 6013(b) and Treas. Reg. §§ 1.451-1(a) and 1.461-1(a)(3)(i). However, the referenced Code sections and Treasury Regulations do not require the taxpayer to file an amended return.

C. No Authority to Accept Amended Returns

Further, there is no authority which requires the IRS to accept amended returns. G.C.M. 35738 (Mar. 21, 1974).

V. INFORMAL ACCEPTANCE OF AMENDED FORMS 706 AND 709

A. Informal Acceptance

As outlined above, there is no substantive authority allowing the filing of amended returns (including Forms 706 or 709) or authority for the IRS to accept amended returns. However, amended returns are common place, not only with respect to income tax returns (where the IRS has issued Forms to facilitate amended filings, e.g., see Form 1040X Amended U.S. Individual Tax Return), but also in the estate and gift tax areas. Amended estate and gift tax returns have been informally accepted by the IRS for some time.

B. IRS Confirmation of Informal Acceptance

In Question and Answer Session I of the Thirty-Fifth Annual University of Miami Philip E. Heckerling
Institute on Estate Planning in 2001, Frances Schafer, an IRS attorney in Washington, D.C., conceded that while there are no provisions that allow for amended gift or estate tax returns, the IRS has seen them and accepted them and treated them as amended returns. See Thirty-Fifth Annual University of Miami Philip E. Heckerling Institute on Estate Planning in 2001, ¶209.2, Matthew Bender, 2001. Ms. Schafer further stated that there was much discussion within the IRS at the time of the so-called “adequate disclosure regulations” of whether the IRS could require taxpayers to file amended gift tax returns in order to comply with such regulations after the initial gift tax return was filed but failed to comply with the new regulations. As discussed below, despite no formal procedures for acceptance of an “amended” gift tax return, the IRS released Revenue Procedure 2000-34 which requires the filing of an amended gift tax return under certain circumstances.

C. Adequate Disclosure Regulations
The statute of limitations on gifts made after December 31, 1996 does not toll as to an item in that return unless the item is disclosed in the return or in a statement attached to a return, in a manner adequate to appraise the IRS of the nature of the item. I.R.C. §6501(c)(9); Treas. Reg. §301.6501(c)-1(f)(1). In 1992 and 1999 the IRS promulgated interpretive regulations under Section 6501(c)(9). These regulations, set forth in Treasury Regulation Section 301.6501(c)-1(f) apply to all gifts made after December 31, 1996.

The IRS released Revenue Procedure 2000-34, 2000-34 I.R.B. 186, to provide guidance for submitting the information required under Treasury Regulation Section 301.6501(c)-1(f)(2) to adequately disclose a gift if the information was not initially submitted with a gift tax return filed for the calendar year in which the gift was made. This revenue procedure provides that if the gift was not adequately disclosed that the donor must file an amended gift tax return to commence the running of the statute of limitations. The amended gift tax return must have the words “Amended Form 709 for gift(s) made in [insert the calendar year that the gift was made] – In accordance with Rev. Proc. 2000-34, 2000-34 I.R.B. 186.”

D. Caselaw
Ms. Schafer’s statement at University of Miami Philip E. Heckerling Institute on Estate Planning in 2001 that the IRS does accept amended gift tax returns is backed up by caselaw in this area. There are numerous estate and gift tax cases in which reference amended estate tax returns or amended gift tax returns. In these cases, the statutory background of the acceptance of the amended returns has not been called into question. See: Estate of O’Neal v. U.S., 258 F.3d 1265 (11th Cir. 2001) (Estate Tax); Estate of Bartels v. Commissioner, 109 T.C. 430 (1996) (Estate Tax); Griffin v. U.S., 42 F. Supp. 2d 700 (D.C. TX 1998) (Gift Tax); Estate of Robinson v. Commissioner, 101 T.C. 499 (1993) (Gift Tax).

VI. IS THERE A DUTY TO FILE SUPPLEMENTAL INFORMATION OR AMENDED RETURNS?
A. General
As discussed above, Section 6011(a) imposes a duty to file a return or statement according to the forms and regulations prescribed by the Secretary. However, once the initial return has been filed, there is not a duty under the Code or Treasury Regulations to file supplemental information or file “amended” returns. See Treas. Reg. §20.6081-1(d) (“Supplemental Information may later be filed . . .”)

B. Supreme Court; Badaracco v. Commissioner
The Supreme Court addressed the issue of amended tax returns in Badaracco v. Commissioner, 464 U.S. 386 (1984), in which the taxpayer filed an amended income tax return after filing an earlier false or fraudulent return for the same tax year in order to begin the statute of limitations running. Part of the Supreme Court’s analysis was focused on the amended returns:

[T]he Internal Revenue Code does not explicitly provide either for the taxpayer’s filing, or for the Commissioner’s acceptance, of an amended return; instead, an amended return is a creature of administrative origin and grace.” Id. at 393

As the Supreme Court noted in Badaracco, nothing in the Internal Revenue Code or the Treasury Regulations requires the filing of an amended return.

VII. ETHICAL CONSIDERATIONS
A. General
In reviewing previously filed Forms 706 and 709, errors on the earlier returns are often found. As discussed above a taxpayer is under no obligation to file supplemental information or an amended return to correct the error. The absence of a legal obligation of the taxpayer does not necessarily resolve the ethical issues confronted by the attorney on discovery of the return error. Harris, “On Requiring the Correction of Error Under the Federal Tax Law”, 42 Tax Lawyer 515, 520 (1989).

B. Treasury Department Circular No. 230
Treasury Department Circular No. 230 contains regulations governing practice of attorneys, certified public accountants, enrolled agents, enrolled actuaries

Section 10.21 of Circular 230 provides as follows:

§10.21 Knowledge of client’s omission.

A practitioner who, having been retained by a client with respect to a matter administered by the Internal Revenue Service, knows that the client has not complied with the revenue laws of the United States or has made an error in or omission from any return, document, affidavit, or other paper which the client submitted or executed under the revenue laws of the United States, must advise the client promptly of the fact of such noncompliance, error or omission. The practitioner must advise the client of the consequences as provided under the Code and regulations of such noncompliance, error or omission.

What is clear from Section 10.21 of Circular 230 is that the attorney is obligated to advise the client of the noncompliance, error or omission. However, it should be noted that Section 10.21 of Circular 230 does not include an obligation to advise clients to amend a previously filed return or other document to correct an inadvertent error. For further discussion on this issue, see Collie & Marinis, “Ethical Considerations on Discovery of Error in Tax Returns”, 22 Tax Lawyer 455 (1969); Harris, “On Requiring the Correction of Error Under the Federal Tax Law”, 42 Tax Lawyer 515 (1989).

C. American Bar Association; Opinion 314

The American Bar Association, in Opinion 314, goes further than Circular 230 and provides that an attorney must not only advise the client of the existence of the error, but must advise that the error should be corrected. ABA Comm. on Professional Ethics, Formal Op. 314 (1965); Harris at 521.

D. Guidelines to Tax Practice

If the error was intentional and may subject the client to criminal prosecution, Opinion 314 does not address if an attorney is required to advise correction of the error. The ABA Tax Section’s Guidelines to Tax Practice recommends that in any situation involving fraud charges, the attorney “should carefully explain to the taxpayer the benefits and hazards of the various options available, including any constitutional right not to cooperate with the Service.” Report of Comm. on Standards of Tax Practice, Guidelines to Tax Practice, 31 Tax Lawyer 551, 553-554 (1978).

E. Formal Opinion 85-352

Formal Opinion 85-352 of the ABA Ethics Committee (“Opinion 85-352”) discussed an attorney’s responsibility in advising a taxpayer with respect to reporting a position on a return. Opinion 85-352 states that with regard to the preparation of returns, an attorney has a duty not to deliberately mislead the IRS, either by misstatements, silence, or by permitting a client to mislead. Pollack, “What Obligations Do Taxpayers and Preparers Have to Correct Errors on Returns?” 72 J. Tax’n 90 (February 1990)

F. Participation With Future Returns

While there is no requirement that the advisor insist that an amended return be filed, or stop representing the client because the amended return is not filed, problems may arise in the future for a practitioner based upon the prior errors. This would exist where the errors have an effect on future returns. Section 10.51 of Circular 230 further restricts an attorney’s future representation about the error before the IRS. Further, Section 10.22(a) of Circular 230 imposes on an advisor duties to exercise due diligence in the preparation of the filing of returns by giving false or misleading information. This would restrict the advisor from signing a subsequent return which the advisor knows incorporates the past error.

VIII. DETERMINING WHETHER TO FILE SUPPLEMENTAL INFORMATION OR AMENDED RETURNS

A. Duty to File Supplemental Information or Amended Returns

As discussed above, there is not an absolute duty to file Supplemental Information or Amended Returns.

B. Tax Ramifications

If errors are in the favor of the taxpayer, strong consideration should be made to filing supplemental information or amended returns.

C. Audit Risk

Filing Supplemental Information or Amended Return may bring the return under more scrutiny on examination. Comisky and Shepard, “How to respond to Discoveries of Tax Return Errors”, Taxation for Accountants (August 1996). While the author’s office has not noticed supplemental information or amended returns to be more likely to result in an audit, audit risk should be carefully reviewed on a case-by-case manner based upon the facts and circumstances of each return.

D. Future Reporting Implications

If items on Forms 706 or 709 are erroneously reported, the effect on future tax reporting should be reviewed. Tax basis implications are one area to address.
1. **Section 1014: Carryover Basis**

Section 1014 states that the basis of property in the hands of a person who acquired the property from the decedent, if not sold, exchanged or otherwise disposed of before the decedent’s death by such person, is the fair market value of the property at the date of the decedent’s death. Treasury Regulation Section 1.1014-3(a) states that the amount reported on Form 706 is deemed to be the property’s fair market value.

In Revenue Ruling 54-97, 1954-1 C.B. 113, the IRS held that for determining carryover basis of the property transmitted at death, the value of the property as determined for the purposes of the Federal estate tax shall be deemed to be its fair market value at the time of acquisition. Except where the taxpayer is estopped by his previous actions or statements, such value is not conclusive but is a presumptive value which may be rebutted by clear and convincing evidence.

2. **Duty of Consistency**

The duty of consistency holds the taxpayer to a representation made for tax purposes if the IRS acquiesced in or relied on it and the statute of limitations bars an adjustment for the earlier year. Stearns v. U.S., 291 U.S. 54 (1934). The duty applies when:

1. the taxpayer has made a representation or reported an item for tax purposes in one year;
2. the IRS has acquiesced in or relied on that act for that year; and
3. the taxpayer desires to change the representation, previously made, in a later year after the statute of limitations bars adjustments for the initial year. Belzer v. United States, 495 F.2d 211, 212 (8th Cir. 1974).

Courts have found a duty of consistency in federal tax cases when the executor and the beneficiary are in privity. See e.g., Estate of Letts v. Commissioner, 109 T.C. 290 (1997) (wife’s estate estopped from asserting that trust did not qualify for QTIP treatment). Generally, courts have equated privity with either fiduciary duties owed by the beneficiary to the estate or a sufficiently closed relationship between the party making the prior representation and the party to be estopped in holding that the beneficiaries could not contradict estate tax values. See Griffith v. U.S., 71-1 USTC ¶9280 (N.D. Tex. 1971) (taxpayer served as executrix of her deceased husband’s estate).

However, TAM 199933001 states that the value on Form 706 represents only a presumptive value that may be rebutted by “clear and convincing evidence” unless the taxpayer’s previous actions or statements preclude his claiming a different value.

E. **Gift Tax; Statute of Limitations**

For gift tax purposes, if the gift was not adequately disclosed under Treasury Regulation Section 301.6501(c)-1(f)(1) the statute of limitations does not begin until the return complies with Regulation.

F. **Avoidance of Penalties and Interest**

While amended returns are not required, there are situations where such a return will avoid penalties and interest that might otherwise apply to the original return. For a summary of civil and criminal penalties in connection with amended returns, See McGown, “Individuals Escape Penalties for Failure to Amend Incorrect Federal Income Tax Returns,” 24 Idaho L.Rev. 235 (1987-1988).

IX. **CONCLUSION**

There is no statutory authority which requires clients to file Supplemental Information (for Form 706) or an Amended Return (for Forms 706 or 709) to correct errors on the original returns. However, attorney’s are ethically obligated to bring noncompliance, errors or omissions to the attention of the client and properly explain the consequences of such issues. Careful consideration must be made to future ramifications of electing to file Supplemental Information or Amended Returns.