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## Farm Assets and Basis at the Death of a Farmer

July 24, 2017



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### Agenda

- Income of the estate
  - Income in respect of a decedent (IRD)
  - Income from the property of the estate
- Filing Form 1041
- Calculate basis of a life estate and a remainder interest, and the gain on the sale of those interests
- Determine the surviving joint tenant's basis in joint tenancy property
- Discuss Portability of deceased spouse's unused exemption (DSUE)

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### Agenda

- Valuation of unharvested crops
- Valuation of Harvested Grain
- Valuation of Breeding Stock
- Identify who has authority to act on behalf of an estate
  - Power of attorney
  - Third party designee
  - Court appointed executor
- Unused credit and loss carryforwards
  - NOL carryforwards
  - Unused charitable deductions
  - Unused capital losses

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### Instructor – Kurt Konek

- Kurt Konek, CPA, brings more than 24 years of certified public accounting experience to his teaching
- His CPA firm, Konek, PC, has offices in Prairie City, Sully, Boone, West Des Moines, and Newton
- Kurt is a member of the AICPA and is a designated Chartered Global Management Accountant
- He also serves as Chair of the Taxation Committee of the Iowa Society of CPAs
- Kurt is a graduate of Iowa State University

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### Tax Returns Resulting from Death

- Form 1040 - US Individual Income Tax Return
  - Reports income from January 1 thru date of death
- Form 1041 – US Income tax Return for Estate and Trusts
  - Reports income after date of death
- Form 706 – US Estate Tax Return
  - Reports assets and liabilities of decedent

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### Basic Issues and Character of Income General Rule

- Estate Tax Purposes
  - Property interests that the decedent owned are valued at FMV as of date of death
- Income Tax Purposes
  - Basis of property in the hands of the decedent's heirs is the properties FMV as of the date of death

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### Post-Death Sale of Livestock, Unharvested Crops, and Land

- Tax treatment of crop (for both income and estate tax purposes) tied to status of decedent at the time of death
  - Was decedent a landlord or farmer?
  - If landlord, was any crop rent accrued at time of death?

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### IRD Exception

- Income in respect of a decedent (IRD) does not receive a step up in basis
- IRD is taxable income earned before death that is received after death
- Not included on decedent's final income tax return

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### IRD

- Examples
  - Accrued interest on government bonds
  - IRA's and 401(k)s
  - Gains on installment sale contracts
  - Growing crops and stored crops of non-material participating farmer
  - Decedent's last paycheck

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## IRD

- Income in Respect of a Decedent – Double Tax
  - Subject to 40% estate tax
  - Subject to Federal income tax as high as 39.6%
  - Subject to State of Iowa income tax as high as 8.98%

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## IRD

- Income in Respect of a Decedent – Double Tax
  - § 691(c) allow as estate tax deduction for income tax purposes
  - The estate tax deduction is easily missed

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## IRD and Farm Lease Income

- Classifying income as IRD depends on status of decedent at time of death
  - Was decedent operating farmer or landlord?
    - If landlord type of lease matters
    - If landlord was there material participation?

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### IRD and Farm Lease Income

- Material participation (Schedule SE)
- The taxpayer materially participated, if they have an arrangement with the tenant for participation and they perform least three of the following:
  - 1. Pay, using cash or credit, at least half the direct costs of producing the crop or livestock
  - 2. Furnished at least half the tools, equipment, and livestock used in the production activities
  - 3. Advise or consult with the tenant
  - 4. Inspect the production activities periodically

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### IRD and Farm Lease Income

- The taxpayer regularly and frequently makes, or takes an important part in making, management decisions, substantially contributing to or affecting the success of the enterprise
- They work 100 hours or more spread over a period of 5 weeks or more in activities connected with agricultural production
- They do things that, considered in their totality, show they are materially and significantly involved in the production of the farm commodities

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### IRD and Farm Lease Income – Form 4835

- Generally, a taxpayer is considered to actively participate if they participated in making management decisions or arranging for others to provide services (such as repairs) in a significant and bona fide sense
- Management decisions that are relevant in this context include approving new tenants, deciding on rental terms, approving capital or repair expenditures, and other similar decisions
- They do not, however, actively participate if at any time during the year their interest (including the spouse's interest) in the activity was less than 10% (by value) of all interests in the activity

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### Operating Farmers and Materially Participating Landlords

- Unsold livestock, growing crops, and grain inventories are NOT IRD – Rev. Rul. 58-436
- Assets included in gross estate and receive a new basis = FMV as of date of death under § 1014
- No allocation is made between decedents estate and final income tax return

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### IRD

- IRD only applies if decedent had a right to receive payment from his/her work efforts at death
  - Estate of Peterson v. Commissioner
- If any material activities have yet to be performed for the conversion of farm products to cash, then the farm products are assets subject to step-up basis rather than IRD

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### IRD

- Farm products delivered before death will always give rise to IRD even for farm operators and materially participating landlord
  - Treas. Reg. § 691(a)-2(b), Example 5

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## IRD

- Farm operators and materially participating landlords must generally deliver their farm products to market
- The act of delivery of farm products is a substantial activity that must be performed by the estate of the decedent, thus the farm products are not IRD

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## Crop Production Expenses

- Expenses incurred prior to death are deducted on Schedule F of decedents Form 1040
- Remaining cost incurred after death are deducted by the decedents estate, Form 1041

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## Livestock

- Active operator or materially participating landlords
  - Step-up in basis = FMV as of Date of Death (DOD)
  - Does not receive Long Term Capital Gain Treatment (LTCGT) if sold before the required holding period (24 months for cattle or 12 months for other livestock)
    - Rev. Rul. 75-361
  - Livestock held for sale generate ordinary income less FMV as of DOD
  - Livestock held for replacement purposes have tax basis, depreciable when placed in service

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### Unharvested Crops

- Pre-death – Grain raised and held for sale or feeding to livestock is inventory
  - Upon sale, proceeds = ordinary income
- Post-death – Grain inventory qualifies for LTCG treatment, even if held < 1 yr., if basis determined under § 1014 DOD FMV rule
- Ordinary income treatment occurs if crop was raised on land that is leased

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### Sale of Farmland with Unharvested Crops

- When farmland sold post-death the crops are treated as part of the farmland
- Amount of gain treated as ordinary (sale of crop) is eliminated
- All receive long term capital gain treatment
- No SE tax on sale of unharvested crop

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### Sale of Farmland with Unharvested Crops

- Example
  - Guy planted soybean crop 4/20/16, died 5/1/16
  - Estate sold the land with unharvested crop on 10/15/16 for \$1.2 million
  - Portion of selling price attributable to soybean crop was \$250,000, and expenses \$100,000

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### Sale of Farmland with Unharvested Crops

- Example Continued
  - If crop was harvested and sold pre-death net profit of \$150,000 (\$250,000-\$100,000) would have been reported on Schedule F, and subject to SE tax
  - With crop sold with land, \$150,000 net crop value is treated as part of § 1231 gain, not subject to SE tax

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### Valuation of Crops at Death

- For Estate tax valuation purposes, crop valued:
  - As of the date of death
  - 6 months after date of death with alternative valuation election
    - Any increase in value attributable to crop growth during 6 month period not directly included in gross estate
      - # of days in rental period up to date of death/total # days in rental period X sales proceeds

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### Alternative Valuation Method

- For Estate tax purposes gross estate normally valued on date of death
- Executor may chose an alternate date - 6 months after date of death
- If property is sold distributed, or disposed of during those six months, value is determined on date of sale, distribution, or disposition
- Alternative valuation method may only be used if both are lowered:
  - Value of the gross estate
  - The sum of estate tax and generation skipping tax

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### Valuation of Unharvested Crops

FMV of unharvested crop needed for:

1. Transfer by sale, gift, or inheritance
2. To make § 754 adjustment
3. To make § 336(e) election
4. To calculate potential built-in gains

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### Valuation of Unharvested Crops

- Valuation of Annual Crops
  - Appraisal by qualified appraiser
  - Discount FMV of crops at harvest

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### Valuation of Unharvested Crops

Appraisal of Growing Crop

Example

<u>Crop</u>	<u>Cost</u>	<u>Growth</u>	<u>FMV</u>
Wheat	\$200	60%	\$320
Soybeans	\$335	15%	\$385
Corn	\$560	15%	\$644

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### Valuation of Unharvested Crops

#### Discounting Harvested Crops

Example:

FMV of harvested wheat	\$100,000
Weather risk	- 12,000
Fire risk	- <u>2,000</u>
Discounted value	\$ 86,000

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### Valuation of Unharvested Crops - Iowa

- State –Level Taxation
  - Some states have specific rules for handling unharvested crops - example
    - Iowa, Iowa Department of Revenue uses a pro-rata approach, IAC § 701-86-11(7)
      - Growing season May 15 thru October 15 (153 days)
    - Formula
      - # days living during growing season/153 X # bushels realized X local elevator price at time of maturity

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### Valuation of Unharvested Crops

- Iowa Example
  - Pete lives in Iowa and raised corn
  - Pete died on August 15 (92 days of growing season)
  - In the fall, harvested 2,000 bu., and sold at local elevator @ \$3.10
  - Value of crop for Iowa inheritance tax purposes is \$3,728
    - $((92 \text{ pre-death days}/153) \times 2,000 \text{ bu.} \times \$3.10)$

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### Valuation of Unharvested Crops

#### Non-Materially Participating Landlord

- If decedent did not materially participate, share rent is IRD
  - No date of death FMV basis
- Must determine FMV on date of death to allocate rent before and after death

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### Cash Rent IRD in Iowa

- Farm Landlord - Iowa Regulations IAC § 701-86.11(8)
  - (# number of days decedent lived during rental period/365) X cash rent for entire year
  - Reduce by rent payments received prior to death, no refunds allowed if negative

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### Cash Rent IRD in Iowa

- The decedent has a cash rent farm lease agreement (beginning March 1 through the end of February of the next year) with Farmer John for automatic yearly rentals
- The rent is due in two installments: \$10,000 on March 1 and \$10,000 on September 1
  - Decedent dies February 1, 2016
    - $\$20,000 \times 338/365 = \$18,520.55$
  - Farmer John had paid his two installments in 2015
  - His next installment is due March 1, 2016, for the new farm rental year
  - Farmer John has overpaid by \$1,479.45 ( $\$18,520.55 - \$20,000 = -\$1,479.45$ )
  - No refund or credit is allowed

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### Cash Rent IRD in Iowa

- 2. Decedent dies April 20, 2016
  - $\$20,000 \times 51/365 = \$2,794.52$
  - Farmer John had paid his March 1 installment of \$10,000
  - Farmer John has overpaid by \$7,205.48 ( $\$2,794.52 - \$10,000 = -\$7,205.48$ )
  - No refund or credit is allowed
- 3. Decedent dies October 10, 2016
  - $\$20,000 \times 224/365 = \$12,273.97$
  - Farmer John paid his March installment but has not paid his September installment
  - Farmer John has underpaid at the date of death
  - $\$12,273.97 - \$10,000 = \$2,273.97$
  - This amount must be reported as an asset
  - It is an accounts receivable due at date of decedent's death

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### Allocation of Farmland Value to Depreciable Property



### Allocation of Farmland Value to Depreciable Property

- Practitioner must ensure sufficient documentation exists to support allocations on tax return

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### Allocation of Farmland Value to Depreciable Property

- Important points to consider when making cost allocations that are likely to survive IRS scrutiny
  - Determine the reasonable FMV of all items associated with the acquisition
    - Roads
    - Tile Lines
    - Fences

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### Allocation of Farmland Value to Depreciable Property

- Determine Reasonable FMV – Continued
  - Make necessary allocations based on the purchase price
    - $(\% \text{ of FMV for each item} / \text{Total FMV}) \times \text{Actual purchase price}$
  - Establish the appropriate depreciable class lives for the various depreciable assets
    - Fence 15 yr.
    - Tile lines and well water 15 yr.
    - Single purpose Ag structure 10 yr.
    - Machine shed 20 yr.

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### Allocation of Farmland Value to Depreciable Property

- Drainage Tile Valuations
  - 2006 IRS MSSP Audit Technique guide suggests using property tax statements for allocation between land and improvements
    - If 40% value is allocated to land, then balance allocated to depreciable property
    - Examiners are warned that too much value may be allocated to tile
  - Previous IRS ATG for farm returns suggest the depreciable cost of tile should approximate 5% of the cost of the bare land (This seems low)

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### Allocation of Farmland Value to Depreciable Property

- Drainage Tile Valuations – continued
  - Establish the Presence of Drainage tile
    - Tile maps
    - Owner depreciation schedules
    - Infrared aerial photos take 1 to 2 days after rain
  - Establish Replacement Cost – common approach
    - \$2.00 / ft. 8-inch tile
    - \$1.65 / ft. 6-inch tile
    - \$1.25 / ft. 4-inch tile

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### Allocation of Farmland Value to Depreciable Property

- Drainage Tile Valuations – continued
  - Once replacement cost establish, that value must be discounted to reflect age and quality of the tile

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### Allocation of Farmland Value to Depreciable Property

- Fences
  - A common approach for allocating cost of fencing has been \$1.50 per foot
  - Fence in good shape
    - 7 yr. depreciable life
    - 150% declining balance - farming

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### Allocation of Farmland Value to Depreciable Property

- Residual Soil Fertility
  - Typically, grid soil sample are utilized to assist in measuring soil fertility
    - Agronomists have established guidelines for determining average (base) soil fertility
- Observation
  - Presently, excess soil fertility rates from \$50 to \$300 per acre in north-central Iowa
  - Useful life is probably 3 to 5 yrs

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### Allocation of Farmland Value to Depreciable Property

- Farm Buildings and other structures
  - Farm Buildings 20 yr.
  - Residential rental 27.5 yrs., maybe 20 yr. farm tenant
  - Hog confinement 10 yrs.
  - Grain bins 7 yr.

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### Estate Planning / Portability




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## Estate Planning

### Pre-Portability Planning

- Outright bequest to spouse:
  - Unlimited marital deduction on transfer to spouse
  - Surviving spouse taxed on 100% of the estate
  - Predeceased spouse's exemption never used
- Bequest to spouse in trust:
  - Credit shelter trust for surviving spouse
  - Predeceased spouse's exemption applied
  - Surviving spouse taxed on 50% of the estate

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## Pre-Portability Trust Planning

- A-B Trust
  - A trust – marital deduction trust for spouse
  - B trust – credit shelter trust for spouse
- A-B-C Trust
  - A trust – revocable trust for spouse's share
  - B trust – credit shelter trust for spouse
  - C trust – marital deduction trust for spouse

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## Example

### Pre-Portability – No Trusts

- Asher died in 2016 - \$5,450,000 to Miranda
- Unlimited marital deduction – no tax
- Miranda died in 2018
  - \$10,900,000 estate
  - (\$5,450,000 exemption)
  - \$5,450,000 taxable estate X 40% = \$2,180,000 estate tax

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### Example

#### Pre-Portability – With Trusts

- Asher died in 2009
- \$3,500,000 to credit shelter (B) trust
- 2009 estate tax exemption \$3,500,000
- \$1,950,000 to marital (A) trust
- Unlimited marital deduction

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### Example - Continued

- Miranda died in 2016
  - B trust assets not included in her estate
  - A trust assets included in her estate
  - \$7,400,000 taxable estate
  - (\$5,450,000 exemption)
  - \$780,000 estate tax -compared to \$2,180,000 in previous example

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### Current Estate Planning

- Portability allows the surviving spouse to use the deceased spouse's unused exemption (DSUE)

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### Example - Portability

- Asher died in 2016
  - \$5,450,000 estate outright to Miranda
- Miranda dies in 2018
  - \$10,900,000 estate
  - (Asher's \$5,450,000 DSUE)
  - (Miranda's \$5,450,000+ exemption)
  - No estate tax

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### Portability Election

- Taxpayer must elect portability on a timely filed estate tax return (Form 706)
- **ADVISE ALL ESTATES, IN WRITING, ABOUT THE BENEFITS OF ELECTING PORTABILITY AND DOCUMENT DECISION TO NOT MAKE THE ELECTION**

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### Portability of Deceased Spousal Unused Exclusion (DSUE)

- § 303 of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 authorized estates of decedents dying after December 31, 2010, to elect to transfer any unused exclusion to the surviving spouse
- The amount received by the surviving spouse is called the deceased spousal unused exclusion, or DSUE, amount
- If the executor of the decedent's estate elects transfer, or portability, of the DSUE amount, the surviving spouse can apply the DSUE amount received from the estate of his or her last deceased spouse against any tax liability arising from subsequent lifetime gifts and transfers at death

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### How do I Elect Portability of the Deceased Spousal Unused Exclusion (DSUE) Amount to Benefit the Surviving Spouse?

- In order to elect portability of the decedent's unused exclusion amount (deceased spousal unused exclusion (DSUE) amount) for the benefit of the surviving spouse, the estate's representative must file an estate tax return (Form 706) and the return must be filed timely
- The due date of the estate tax return is nine months after the decedent's date of death, however, the estate's representative may request an extension of time to file the return for up to six months
- An automatic six month extension of time to file the return is available to all estates, including those filing solely to elect portability, by filing Form 4768 on or before the due date of the estate tax return

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### Form 4768

Form **4768** Application for Extension of Time To File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes OMB No. 1545-0041

**Part I Identification**

Decedent's name and social security number

Name of executor

Name of application filer (if other than the executor)

Decedent's social security number

Address of executor

(Number, street, and room or suite no.)

Estate tax return due date

City, state, and ZIP code

Decedent's date of death (month, day, and year)

Decedent's telephone number

**Part II Extension of Time To File Form 706, 706-A, 706-D, 706-NA, or 706-GDT (Section 6081)**

Automatic Extension

If you are applying for an automatic 6-month extension of time to file:

- Form 706, check here ☐
- Form 706-A, 706-D, 706-NA, or 706-GDT, indicate the form by checking the appropriate box below:
  - ☐ Form 706-A ☐ Form 706-D ☐ Form 706-NA ☐ Form 706-GDT

Additional Extension

If you are an executor out of the country applying for an extension of time to file in excess of 6 months, check here ☐. Also you must attach a statement explaining in detail why it is impossible or impractical to file Form 706 by the due date. See instructions.

**Part III Extension of Time To Pay (Section 6161)**

You must attach your written statement to explain in detail why it is impossible or impractical to pay the full amount of the estate (or GDT) tax by the return due date. If the taxes cannot be determined because the size of the gross estate is unascertainable, check here ☐ and enter "G" or other appropriate amount on Part IV, line 3. You must attach an explanation.

- If this request is for the tax that will be or was due with the filing of Form 706, check here ☐
- If this request is for the tax that will be or was due as a result of an amended or supplemental Form 706, check here ☐

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### IRS Issues Simplified Procedure for Making a Late Portability Election

- IRS has just made it easier and much less costly to file a late Form 706 to elect portability
- Effective June 9, 2017, Rev. Proc. 2017-34, creates a simplified method for making a late portability election, as long as the estate was only required to file Form 706 for the purpose of electing portability
- This is a great benefit to the many executors (and their practitioners) who may miss this deadline

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## Background

- Decedent's dying in 2017 can transfer (during their lifetime and/or at death) up to \$5.49 million without federal estate or gift tax liability
- This is called the "basic exclusion" amount
- The American Taxpayer Relief Act of 2012 made permanent a "portability election," which allows the estate of a decedent survived by a spouse to elect to transfer the deceased spouse's unused exclusion amount (DSUE) to the surviving spouse

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## Background

- If the estate elects portability, the estate of the surviving spouse (at his or her death) can apply the DSUE of the surviving spouse's last deceased spouse to the surviving spouse's transfers
- In other words, portability ensures that a married couple can take full advantage of each spouse's basic exclusion amount, without the requirement of special trusts or other estate planning techniques

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## Rev. Proc. 2017-34

- The difficulty is that portability must be elected on a timely filed Form 706 (Estate Tax Return)
- This means that the Form 706 must be filed within 9 months after the decedent's death or by the last day of the period covered by a timely-filed extension request
- This doesn't always happen
- In 2014, IRS granted a simplified procedure for requesting an extension to elect portability by issuing Rev. Proc. 2014-18

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### Rev. Proc. 2017-34

- This temporary relief, however, expired at the end of 2014
- Since then, the only option for relief available to an executor who missed the portability election deadline was to seek a private letter ruling
- Although IRS seemed to freely grant many extensions requested via private letter ruling, the estate had the burden and significant expense of the PLR procedure, and the IRS had the burden of processing all of the requests

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### Rev. Proc. 2017-34

- Enter Rev. Proc. 2017-34
- Under this new procedure, IRS will grant automatic relief under Treas. Reg. § 301.9100-3 and extend the time to elect portability for certain qualified returns

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### The Relief Applies Where:

- The decedent was a citizen of the U.S. at death, was survived by a spouse, and died after December 31, 2010
- The executor is not required to file an estate tax return under IRC § 6018(a) (based upon value of gross estate)(i.e. executor is only filing the Form 706 to elect portability) AND
- The executor did not file a timely Form 706

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### Rev. Proc. 2017-34

- If these requirements, are met, the executor must file the complete and properly prepared Form 706 on or before the later of
  - (1) January 2, 2018, OR
  - (2) the second anniversary of the decedent's date of death
- The Form 706 must state at the top that the return is "FILED PURSUANT TO REV. PROC. 2017-34 TO ELECT PORTABILITY UNDER § 2010(c)(5)(A)"
- If the executor satisfies the above requirements, the Rev. Proc. 2017-34 states that the Form 706 filed by the estate will be considered to have been timely filed under Treas. Reg. § 20.2010-2(a)(1)

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### Opting Out of Portability

- If you are filing Form 706 and do not wish to elect portability, then check the box indicated
- Do not complete sections B or C

Estate of: \_\_\_\_\_ Decedent's social security number \_\_\_\_\_

Part 6—Portability of Deceased Spousal Unused Exclusion (DSUE)

**Portability Election**  
A decedent with a surviving spouse elects portability of the deceased spousal unused exclusion (DSUE) amount, if any, by completing and timely filing this return. No further action is required to elect portability of the DSUE amount to allow the surviving spouse to use the decedent's DSUE amount.

**Section A. Opting Out of Portability**  
The estate of a decedent with a surviving spouse may opt out of electing portability of the DSUE amount. Check here and do not complete Sections B and C of Part 6 only if the estate opts **NOT** to elect portability of the DSUE amount. ☐

**Section B. QDOT**  
Are any assets of the estate being transferred to a qualified domestic trust (QDOT)? . . . . . ☐ **Yes** ☐ **No**  
If "Yes," the DSUE amount portable to a surviving spouse (calculated in Section C, below) is preliminary and shall be redetermined at the time of the final distribution or other taxable event imposing estate tax under section 2056A. See instructions for more details.

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### Income of the Estate

- Income of the estate includes:
  - Income in respect of a decedent (IRD), e.g. unpaid salary or accounts receivable
  - Income from property of the estate

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### IRD

- IRD is gross income that is not included in the decedent's final tax year.
  - No step-up or step-down in basis
  - Taxable to the beneficiary if distributed
  - Estate reports on Schedule K-1 (Form 1041)

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### Other Estate Income

- Other income is taxed to the estate if:
  - Accumulated in the estate and
  - Not deemed distributed
- Other income is taxed to beneficiary if:
  - Actually distributed or
  - Must be distributed

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### Property that Vests Automatically

- Property that vests automatically under state law
  - Taxable to estate if subject to administration
  - Taxable to heirs if executor is not entitled to possession and control
- Example
  - Corey inherited a farm in NC from his father
  - Under NC law, title vests upon death and the heirs are entitled to possession and control
  - Farm rental payment is taxed to Corey

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### Form 1041

#### Filing Requirements

- File if:
  - Estate has income \$600 or more, or
  - Any beneficiary is nonresident alien
- File by due date for Form 1040
- Automatic extension by Filing Form 7004
- Beginning 2016, extension to September 30

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### Collection of Tax from Heirs

- Heir can be liable for estate income tax due and not paid
- Limited to value of assets the heir received
- Collection may be barred by:
  - Statute of limitations
  - Res judicata

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### Basis of Assets - Transferred at Death

- Basis of life estate
  - Sale of life estate
  - Sale of entire property
  - Sale of remainder interest
  - Death of life owner or remainder owner
- Basis of jointly owned property

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### Basis of Life Estate

- Uniform basis allocated between life interest and remainder interest
- Values determined by Table S
  - Life expectancy
  - Assumed investment return (I.R.C. § 7520)
- Uniform basis multiplied by life estate factor

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### Example 4.18

#### Basis of Life Estate

- Bea died, leaving life estate to June (Age 48 ) with the remainder to Jeff
- \$500,000 basis
- I.R.C. §7520 rate 1.8%
  - Life estate factor from Table S is 0.41834
  - Basis of life estate is \$209,170 (life estate factor times basis)
  - Basis of remainder is \$290,830 (uniform basis minus life estate basis)

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### Actuarial Tables

- <https://www.irs.gov/retirement-plans/actuarial-tables>

40	27.0335	0.48660	0.51340	95	3.0173	0.05431	0.94569
41	26.5752	0.47835	0.52165	96	2.8244	0.05084	0.94916
42	26.1124	0.47002	0.52998	97	2.6436	0.04758	0.95242
43	25.6446	0.46160	0.53840	98	2.4739	0.04453	0.95547
44	25.1724	0.45310	0.54690	99	2.3146	0.04166	0.95834
45	24.6959	0.44453	0.55547	100	2.1668	0.03900	0.96100
46	24.2149	0.43587	0.56413	101	2.0271	0.03649	0.96351
47	23.7301	0.42714	0.57286	102	1.8983	0.03417	0.96583
48	23.2412	0.41834	0.58166	103	1.7709	0.03188	0.96812
49	22.7483	0.40947	0.59053	104	1.6539	0.02977	0.97023
50	22.2507	0.40051	0.59949	105	1.5385	0.02769	0.97231
51	21.7489	0.39148	0.60852	106	1.3954	0.02512	0.97488
52	21.2429	0.38237	0.61763	107	1.2340	0.02221	0.97779
53	20.7331	0.37320	0.62680	108	0.9780	0.01760	0.98240
54	20.2203	0.36397	0.63603	109	0.4912	0.00884	0.99116

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<https://www.irs.gov/businesses/small-businesses-self-employed/section-7520-interest-rates> - Current

### Section 7520 Interest Rates

To be used to value certain charitable interests in trusts. Pursuant to Internal Revenue Code 7520, the interest rate for a particular month is the rate that is 120 percent of the applicable federal midterm rate (compounded annually) for the month in which the valuation date falls. That rate is then rounded to the nearest two-tenths of one percent. For example, the rate that is 120 percent of the applicable federal rate (compounded annually) for June 2012 is 1.28 percent. That rate is then rounded to the nearest two-tenths of one percent or 1.2 percent for purposes of IRC 7520.

Section 7520 Interest Rates

Valuation Month	120% of Applicable Federal Midterm Rate	Section 7520 Interest Rate	Revenue Ruling
January 2017	2.36	2.4	2017-2
February 2017	2.63	2.6	2017-4
March 2017	2.47	2.4	2017-7
April 2017	2.55	2.6	2017-8
May 2017	2.45	2.4	2017-11
June 2017	2.35	2.4	2017-12
July 2017	2.27	2.2	2017-14

For prior years' rates, please refer to [Section 7520 Interest Rates for Prior Years](#).

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### Allocation of Basis

- Basis of life estate decreases over time
- Example
  - Life estate to Betty (Age 53) remainder to Lee
  - Betty's basis is \$200,255 (from Table S) and Lee's remainder basis is \$299,745
  - When Betty is age 70 basis in life estate is \$108,720 and Lee's remainder basis is \$391,280

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### Basis Adjustments

- Betty adds improvements \$30,000 and takes depreciation deductions \$15,000
- Betty's basis increases by \$5,598
- \$15,000 basis increase (30,000-15,000)
- \$15,000 x 0.37320 (Table S factor) = \$5,598

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Table S



45	24.6959	0.44453	0.55547	100	2.1668	0.03900	0.96100
46	24.2149	0.43587	0.56413	101	2.0271	0.03649	0.96351
47	23.7301	0.42714	0.57286	102	1.8983	0.03417	0.96583
48	23.2412	0.41834	0.58166	103	1.7709	0.03188	0.96812
49	22.7483	0.40947	0.59053	104	1.6539	0.02977	0.97023
50	22.2507	0.40051	0.59949	105	1.5385	0.02769	0.97231
51	21.7489	0.39148	0.60852	106	1.3954	0.02512	0.97488
52	21.2429	0.38237	0.61763	107	1.2340	0.02221	0.97779
53	20.7331	0.37320	0.62680	108	0.9780	0.01760	0.98240
54	20.2203	0.36397	0.63603	109	0.4912	0.00884	0.99116

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### Sale of Life Estate

- On sale life tenant cannot claim separate basis – full amount received is gain
- Life estate to Ashley remainder to Susan
- Basis \$269,815 at time of sale
- Sale price \$300,000
- Basis is disregarded - Ashley taxed on \$300,000

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### Sale of Remainder

- Sale of remainder interest – disregarded basis rule does not apply
- Taxed on difference between sale price and basis
- Sales Price \$400,000, remainder basis calculated to be \$230,185, taxable gain \$169,815

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### Sale of Entire Property

- Allocate basis between life estate and remainder
- Allocate sale price between life estate and remainder
- Sell entire property for \$700,000
- Life estate basis \$269,815 and remainder \$230,815
- Life estate basis is 54% of total basis
- 54% of sale proceeds allocated to life estate

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### Death of Life Tenant or Remainder Person

- No adjustment to basis if neither owned the interest held by the other
- If life tenant gave remainder interest to remainder person, step-up to FMV
- Ashley (life tenant) dies and Susan (remainder person) has 100% ownership DOD value \$500,000 + \$50,000 improvements.
- Susan takes full adjusted uniform basis \$550K
- No step-up

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### Death of Life Tenant - Continued

- Step-up in basis if remainder created by gift from life tenant
- Ashley reserved life estate for herself and gave Susan a remainder interest
- Ashley dies:
  - FMV included in her estate \$850,000
  - Susan gets stepped-up basis \$850,000

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### Death of Remainder Person

- No adjustment to uniform basis
- Heir of remainder person gets new basis
- Life estate to Catherine remainder to Edna
- Edna dies when house is valued at \$160,000
- Value of remainder interest is \$109,173 (\$160,000 x Table S remainder factor)
- Remainder passes to Sophie - \$109,173 basis

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### Estate Inclusion of Jointly Owned Property

- I.R.C. §2040 jointly owned property included in estate except:
  - Certain acquisitions by husband and wife as tenancy by the entirety, include  $\frac{1}{2}$
  - Certain acquisitions as JTWRROS, include fractional share
  - Decedent and spouse own as tenants by the entirety or JTWRROS, include  $\frac{1}{2}$
  - Jointly Owned with Rights of Survivorship (JTWRROS)

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### Basis Non-Spousal Joint Tenants

- Step-up or step-down in basis of joint tenant's share if that share was included in the estate of the joint tenant
- Example
  - Mollie & Adam own as JTWRROS (70% & 30%)
  - Mollie dies 2016, FMV \$200,000
  - \$140,000 (70% x \$200,000) included in her estate
  - Adam gets \$140,000 basis in Mollie's share

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### Basis Spousal Joint Tenants

- Non-community property state
  - Surviving spouse gets step-up (or step-down) in joint interest of deceased spouse
- Community property state
  - Surviving spouse gets full step-up (or step-down)

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### Special-Use Valuation




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### Special-Use Valuation

- Under IRC § 2032A, an estate may elect to value property used in farming , or other closely held business, at its **current use for agricultural purposes** rather than at it highest and best use

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### Special-Use Valuation

- Requirements which must be satisfied by the decedent for a particular period of time before death, by the estate at the time of death, and by the qualified heirs(s) after death
  - Requirements for real estate
  - Percentage tests
  - Qualified-use test
  - Material participation test
  - Ownership test
  - Qualified heir test
  - Present-interest test

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### Special-Use Valuation

- Requirements for real estate
  - Located in the United States
  - Acquired from or passed from the decedent to a qualified heir
  - Used for qualified use by the decedent, or a member of the decedent's family, for a certain length of time before death and at the time of the decedent's death

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### Special-Use Valuation

- Percentage Tests
  - 50% Tests
    - The farming or ranching property (both real and personal) must **make up at least 50%** of the adjusted value of the gross estate
      - Value at FMV
      - At least that amount must pass to qualified heirs

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### Special-Use Valuation

- Percentage Tests
  - 25% Tests
    - The farmland itself must make up **at least 25%** of the adjusted value (FMV less allowable indebtedness) of the gross estate
    - Must be passed from the decedent to a qualified heir

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### Special-Use Valuation

- Qualified-Use Test
  - Requires the **decedent or family member** to have had an equity interest in the farm operation at each of the following times:
    - The time of death
    - For five or more of the last eight years before death
    - During the 10 year post-death period

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### Special-Use Valuation

- Material Participation Test
  - This test requires active involvement in the farm or ranch business by the decedent or a member of the decedent's family 5 of the last 8 years before the earlier of:
    - Retirement
    - Disability
    - Death

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### Special-Use Valuation

- **Material Participation Test**
  - This test can be satisfied with:
    - Crop-share lease, with great involvement
    - Custom farming operation
    - Direct farming operation
  - Cash-rent lease usually will not satisfy the test

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### Special-Use Valuation

- **Ownership Test**
  - The real estate must have been owned by the decedent, or a member of the family, and held for a qualified use during 5 or more years in the 8-year period ending with the decedent's death

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### Special-Use Valuation

- **Qualified Heir Test**
  - A qualified heir must be a "member of the family" who acquired property (or to who the property passed) from the decedent
  - Statutory definition of member of the family depends upon whether measuring period is the pre-death or post-death period

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### Special-Use Valuation

- Qualified Heir Test
  - Pre-death period, who qualifies as a **member of the family** is determined in accordance with the relationship to the decedent
  - After death, who qualifies as a **member of the family** is determined in accordance with their relationship to the qualified heir

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### Special-Use Valuation

- Present-Interest Test
  - Elected property is deemed to pass to a qualified heir only if the qualified heir received a present interest in the property

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### Special-Use Valuation

- Calculating Special-Use Value
  - Two methods to calculate
    - Rent Capitalization
    - 5-Factor Formula

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Special-Use Valuation

- Calculating Special-Use Value
  - Rent Capitalization Approach – Formula
    - The average annual gross cash rent per acre minus property tax on comparable land, divided by
    - The average annual effective Farm Credit Bank interest rate for the last five years

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Special-Use Valuation

- 5-Factor Formula Approach
  - If the estate can show there are no comparable cash-rent tracts, or if the representative elects, this procedure may be used

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Special-Use Valuation

- 5-Factor Formula Approach
  - This approach used following 5 factors
    - Capitalization on income
    - Capitalization of rent
    - Assessed value for property taxes
    - Comparable sales in the same geographic area
    - Any other factor that fairly values the property

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## Special-Use Valuation

- Making the Election
  - Election is made on Form 706
    - Mark box on Part 3, line 2
    - Attach Schedule A-1

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## Form 706

Form 706 (Rev. 4/2013)

Decedent's social security number

Estate of:

### Part 3—Elections by the Executor

Note. For information on electing portability of the decedent's DSUE amount, including how to opt out of the election, see Part 6—Portability of Decedent's Spousal Unused Exclusion.

Note. Some of the following elections may require the posting of bonds or liens.

Please check "Yes" or "No" box for each question (see instructions).

	Yes	No
1 Do you elect alternate valuation?		
2 Do you elect special-use valuation? If "Yes," you must complete and attach Schedule A-1		
3 Do you elect to pay the taxes in installments as described in section 6166? If "Yes," you must attach the additional information described in the instructions. Note. By electing section 6166 installment payments, you may be required to provide security for estate tax deferred under section 6166 and interest in the form of a surety bond or a section 6224A lien.		
4 Do you elect to postpone the part of the taxes due to a reversionary or remainder interest as described in section 6163?		

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## Schedule A-1

Form 706 (Rev. 4/2013)

Decedent's social security number

Estate of:

### SCHEDULE A-1—Section 2032A Valuation

Part 1. Type of election (Before making an election, see the checklist in the instructions):

☐ Protective election (Regulations section 20.2032A-6(b)). Complete Part 2, line 1, and column A of lines 3 and 4. (See instructions.)

☐ Regular election. Complete all of Part 2 (including line 11, if applicable) and Part 3. (See instructions.)

Before completing Schedule A-1, see the instructions for the information and documents that must be included to make a valid election.

The election is not valid unless the agreement (that is, Part 3, Agreement to Special Valuation Under Section 2032A):

- is signed by each qualified heir with an interest in the specially valued property and
- is attached to this return when it is filed.

Part 2. Notice of election (Regulations section 20.2032A-6(a)(2)).

Note. All real property entered on lines 2 and 3 must also be entered on Schedules A, E, F, G, or H, as applicable.

1 Qualified use—check one ☐ Farm used for farming, or ☐ Trade or business other than farming

2 Real property used in a qualified use, passing to qualified heirs, and to be specially valued on this Form 706.

A	B	C	D
Schedule and item number from Form 706	Full value (without section 2032A(b)(3)(B) adjustment)	Adjusted value (with section 2032A(b)(3)(B) adjustment)	Value based on qualified use (without section 2032A(b)(3)(B) adjustment)

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### Special-Use Valuation

- Special Lien
  - A special estate tax lien is imposed on all qualified farm or closely held business real property for which a special-use valuation election was made

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### Special-Use Valuation

- Recapture tax
  - 10 year post death = Recapture Period
    - May be extended up to 2 years
  - Executor files a recapture agreement signed by each person who has an interest
    - Consent to personal liability in case of disqualifying event

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### Special-Use Valuation

- Recapture tax
  - Lowest of:
    - The adjusted tax difference attributable to such interest
    - The excess of the amount realized with respect to the interest over the value based on the use under which the property qualifies
    - The excess of the Property's FMV over the value on the use under which the property qualifies.

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### Special-Use Valuation

- Recapture tax
  - Events that Trigger Recapture:
    - Transfer outside of family
    - Lack of material participation
    - Change in use
    - No qualified use

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### Pre-Death Planning

- Gift assets
- Sell assets
- Establish trust

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### Representation and Basis Consistency



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### Authority to Act

- State law power of attorney
  - Terminates upon death
- Third party designee
  - Terminates upon death
- Court appointed executor
  - Authority to act on behalf of the estate
  - Must file Form 56 to notify IRS of the fiduciary relationship

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### Who Has Authority to Act on Behalf of an Estate

- To establish that a taxpayer is properly authorized to receive tax information of a decedent or their estate, submit the following with any information request to the IRS
  - The decedent's complete name, address and social security number
  - A copy of the death certificate, and either
  - A copy of Letters Testamentary approved by the court, or
  - IRS Form 56, Notice Concerning Fiduciary Relationship, if there is no court proceeding

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### Form 56

- IRS is revising Form 56 – the new version is still in draft form – November 2017

**Form 56**  
Rev. November 2013  
Department of the Treasury  
Internal Revenue Service

**Notice Concerning Fiduciary Relationship**  
► Information about Form 56 and its separate instructions is at [www.irs.gov/Form56](http://www.irs.gov/Form56).  
Internal Revenue Code sections 6039 and 6040

CMB No. 1545-0013

**Part I Identification**

Name of person for whom you are acting (as shown on the tax return) \_\_\_\_\_ Identifying number \_\_\_\_\_ Decedent's social security no. \_\_\_\_\_

Address of person for whom you are acting (990-100, 990-100, and 990-100) \_\_\_\_\_  
City or town, state, and ZIP code (if 4-digit ZIP code, add 990-100, 990-100, 990-100) \_\_\_\_\_

Fiduciary's name \_\_\_\_\_  
Address of fiduciary number, 990-100, 990-100, and 990-100 \_\_\_\_\_  
City or town, state, and ZIP code \_\_\_\_\_ Telephone number (optional) \_\_\_\_\_

**Section A. Authority**

1. Authority for receiving information: Check appropriate box:  
☐ a. Court appointment of fiduciary estate (no valid will exists)  
☐ b. Court appointment of intestate estate (no valid will exists)  
☐ c. Court appointment as guardian or conservator  
☐ d. Valid trust instrument and amendments  
☐ e. Bankruptcy or assignment for the benefit of creditors  
☐ f. Other. Describe: \_\_\_\_\_

2a. If box 1a or 1b is checked, enter the date of death: \_\_\_\_\_  
 b. If box 1c – 1f is checked, enter the date of appointment, taking office, or assignment or transfer of assets: \_\_\_\_\_

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### Form 56- Notice Concerning Fiduciary Relationship

- A separate Form 56 must be filed for the fiduciary filing of the decedent's final Form 1040 and for the fiduciary of the decedent's estate, even if the same fiduciary is handling both
- The personal representative must notify IRS at the creation of a fiduciary relationship, a change in the fiduciary or the termination of the fiduciary relationship
- **Note:** a personal representative may become personally liable for any unpaid taxes if they distribute assets, the estate is insolvent as a result and the personal representative was aware of the tax due

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### Power of Attorney – Form 2848

- Trusts
  - Enter the name, title, and address of the trustee, and the name and EIN of the trust
- Deceased individuals
  - For Form 1040, enter the name and SSN (or ITIN) of the decedent as well as the name, title, and address of the decedent's executor or personal representative
- Estates
  - Enter the name of the decedent as well as the name, title, and address of the decedent's executor or personal representative
  - For Forms 706, enter the decedent's SSN (or ITIN) for the taxpayer identification number

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### Court Appointed Representative/Executor

- A person who manages the financial affairs of another person who is unable to do so – finish the decedent's financial and business matters, filing the decedent's last tax returns, and distributing the estate to the heirs
- In special instances, courts appoint one of three types of administrators
- They are appointed when
  - (1) an executor cannot or will not serve
  - (2) a prior executor or administrator has not completed the estate
  - (3) an interim administrator given restricted powers over the estate, is needed until a proper legal representative can be found

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## Authority to Act

### When no fiduciary appointed

- Signing return - Surviving spouse signs joint return
- If none, person in charge of property signs as "personal representative"
- Requesting information - Heir, next of kin, beneficiary, or donee with material interest affected by the requested information
- Power to act - Residuary legatee or distributee

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## New Form 8971

- The Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 requires executors of an estate (Form 1041) and other persons who are required to file Form 706 series, United States Estate (and Generation-Skipping Transfer) Tax Return, to report the final estate tax value of property distributed or to be distributed from the estate, if the estate tax return is filed after July 2015
- Form 8971, along with a copy of every Schedule A, is used to report values to the IRS
- One Schedule A is provided to each beneficiary receiving property from an estate

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## Form 8971

<b>8971</b> United States Internal Revenue Service	<b>Information Regarding Beneficiaries          Acquiring Property From a Decedent</b>	(OMB No. 1545-0046)
▶ Information about Form 8971 and its separate instructions is at <a href="http://www.irs.gov/form8971">www.irs.gov/form8971</a> .		
Check box if this is a supplemental filing <input type="checkbox"/>		
<b>Part I Decedent and Executor Information</b>		
Decedent's name		3 Decedent's date of death 5 Executor's phone no.
4 Executor's name (see instructions)		6 Decedent's SSN 7 Executor's TIN
8 If there are multiple executors, check here <input type="checkbox"/> and attach a statement showing the names, addresses, telephone numbers, and Title of the additional executor(s).		
9 If the estate selected alternate valuation, indicate the alternate valuation date:		
<b>Part II Beneficiary Information</b>		
10 If you are expected to receive property from the estate? <input type="checkbox"/> If so, each beneficiary, provide the information requested below. If more space is needed, attach a statement showing the requested information for the additional beneficiaries.		
A Name of Beneficiary	B TIN	C Address, City, State, ZIP
D Date Provided		

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Form 8971 – Schedule A

Form 8971 (2-2015)

**SCHEDULE A—Information Regarding Beneficiaries Acquiring Property From a Decedent**  
Information about Form 8971 (including Schedule A) and its separate instructions is at [www.irs.gov/form8971](http://www.irs.gov/form8971).

Check box if this is a supplemental filing: ☐

**Part 1. General Information**  
1. Decedent's name  
2. Decedent's SSN  
3. Beneficiary's name  
4. Beneficiary's TIN  
5. Executor's name  
6. Executor's address  
7. Executor's phone no.

**Part 2. Information on Property Acquired**

A	B	C	D	E
Item No.	Description of property acquired from the decedent and the Schedule and Item number where reported on the decedent's Form 706. Include those estate and generation-skipping transfer tax returns. If the beneficiary acquired a partial interest in the property, indicate the interest acquired here.	Did this asset include estate tax liability? (Y/N)	Valuation Date	Estate Tax Amount (in U.S. dollars)
1	Form 706, Schedule _____, Item _____ Description —			

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Notice 2016-27

- Estates had until June 30, 2016 to file estate basis for estates after July 31, 2015
- After that they have 30 days after filing Form 706 or 1041

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Credits and Carryovers –  
What Happens to Them Upon Death



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### General Credits on the Final Return (1040)

- The final Form 1040 allows a deceased taxpayer to claim certain credits even though the return covers the part of the year the taxpayer was alive
- As long as the taxpayer meets the qualifications of the following credit during their final year they can claim:
  - Earned Income Tax Credit – even if the taxpayer would not have qualified with a full years of income
  - If the allowable credit is more than the tax liability for the year, the excess is refunded
- Though the taxpayer's year was not a full 12 months, their time alive constitutes their tax year

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### Credit for the Elderly or the Disabled

- This credit is allowable on a decedent's final income tax return if the decedent meets both of the following requirements in the year of death
- The decedent:
  - Was a "qualified individual," and
  - Had income (adjusted gross income (AGI) and nontaxable social security and pensions) less than certain limits

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### Child Tax Credit

- If the decedent had a qualifying child, they may be able to claim the child tax credit on the decedent's final return even though the return covers less than 12 months
- The taxpayer may be able to claim the additional child tax credit and get a refund if the credit is more than the decedent's liability

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### Adoption Credit

- Depending upon when the adoption was finalized, this credit may be taken on a decedent's final income tax return if the decedent:
- Adopted an eligible child and paid qualified adoption expenses, or
- Has a carryforward of an adoption credit from a prior year
- Also, if the decedent is survived by a spouse who meets the filing status of qualifying widow(er), unused adoption credit may be carried forward and used following the death of the decedent

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### General Business Credits Form 3800

- If the taxpayer have an unused credit after carrying it back 1 year, they can carry it forward to each of the 20 tax years after the year of the credit
- Any qualified business credits that are unused after the last tax year of the 20-year carryforward period (or at the time an individual taxpayer dies or other taxpayer, such as a corporation or partnership, ceases to exist) may be taken as a deduction in the earlier of:
  - The tax year following the last tax year of the 20-year carryforward period, or
  - The tax year in which the individual taxpayer dies or other taxpayer ceases to exist

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### § 196(c) Credits - Qualify

- The investment credit
- The work opportunity credit
- The alcohol fuels credit
- The research credit
- The enhanced oil recovery credit
- The empowerment zone employment credit
- The Indian employment credit
- The employer social security credit
- The new markets credit
- The small employer pension plan startup cost credit

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### § 196(c) Credits - Qualify

- The biodiesel fuels credit
- The low sulfur diesel fuel production credit
- The new energy efficient home credit and
- The small employer health insurance credit § 196(c)

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### § 196(c) Credits - Qualify

- Generally, the entire unused portion of these credits is allowed as a deduction
- Only 50 percent of the unused portion of the investment credit (other than the rehabilitation credit) is allowed as a deduction
- In addition, only 50 percent of the unused portion of the research credit for a tax year before 1990 is allowed as a deduction

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### Order of Application

- First general business credit carryforwards are used first
- Second the general business credits for the current tax year are used
- Finally, any general business credit carrybacks are used
- When relevant, the components of the general business credit reported on Form 3800 arising in a single tax year are used in the following order – some credits have priority

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## Loss Carryforwards

- Net operating losses (NOLs)
- Passive losses
- Charitable contributions
- Capital losses

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## Basics

- Generally, carryovers can be used on the decedent's final income tax return but are lost thereafter – pretty straight forward for a single individual
- When there is a spouse it can be more complex
- If the surviving spouse files a joint return with the decedent for the year of death, the full amount of carryovers can still be used in the year of death, even if they are used to offset income of the surviving spouse that was generated after death

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## Basics

- After the year of death, the carryovers must be examined
- A determination must be made as to what carryovers apply to the decedent and thus are lost – remember if the couple were married for many years and losses occurred, the carryovers may or may not apply to both spouses
- There could also be several types of carryovers
- Therefore each carryover must be allocated to each spouse

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### Capital Losses

- Capital losses cannot be carried over after a taxpayer's death
- They are deductible only on the final income tax return filed on the decedent's behalf
- The yearly limit still applies in this situation
- Even if the loss is greater than the limit, the decedent's estate cannot deduct the difference or carry it over to following years
- Surviving spouse cannot use capital loss carryovers from decedent
- Pub 544 page 38 and review Rev. Rul. 74-175

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### Capital Losses

- They are deductible only by the taxpayer who sustained the loss
- Tracking of ownership of the losses is necessary
- If property is jointly held and a loss is generated and not fully utilized before one spouse, then only half of the loss is allocated to the surviving spouse and can be carried forward

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### NOL Carry forwards

- General rule:
  - Carryback 2 years
  - Carryforward 20 years
- NOL of a decedent:
  - Can only be deducted on decedent's final income tax return

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### Net Operating Losses

- These are deductible only by the taxpayer who sustained the losses, there is no way to transfer these to any other taxpayer even the spouse
- When looking at NOL's they often occur with businesses – so unless the couple were joint owners of the business only one will benefit from the losses
- For example- a farmer is the sole person reporting income from the farm – IRS will look to traced the spouse business activity
- Generally, the loss will be attributed to the spouse who generated the loss

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### Net Operating Losses

- For a farm sole proprietorship, the NOL is attributed to the spouse who is the sole owner of the business
- When dealing with a family-owned business operating as a disregarded entity, an S corporations or as a partnerships, losses are passed through to the business owners
- Any NOL on a joint tax return can be attributed to each spouse based on ownership in the business
- Whatever amount of a decedent's NOL is not used in the year of death is lost
- Rev. Rul. 74-175 specifically addressed NOL carryovers, providing that only the taxpayer who sustained the loss can use these carryovers

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### NOL Planning Pointers

- Carry NOL back
  - Amend decedent's prior-year return
- Offset surviving spouse income on final return
  - Sell separately owned assets at a gain
  - Take a taxable distribution from an IRA

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### Passive Activity Loss Carryovers

- Your client may die with suspended passive activity losses (PALs)
- The PAL must be traced to the owner of the activity
- § 469(g)(2)(b), states any of the decedent's PAL carryover is allowed on the final joint return for the year of death, as the activity is considered terminated, BUT

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### Passive Activity Loss Carryovers

- We must make a basis adjustment to determine the amount of carryover that can be deducted on the final return
- Use Form 8582, Passive Activity Loss Limitations, to summarize losses and income from passive activities and to figure the amounts allowed

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### Passive Activity Loss Carryovers - Limitation

- If a passive activity interest is transferred because a taxpayer dies, the accumulated unused passive activity losses are allowed as a deduction against the decedent's income in the year of death
- Losses are allowed only to the extent they are greater than the excess of the transferee's (recipient of the interest transferred) basis in the property
- Over the decedent's adjusted basis in the property immediately before death
- The part of the accumulated losses equal to the excess is not allowed as a deduction for any tax year

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### Unused Charitable Deductions

- General rule:
  - Deduction limited to 50% of AGI for gifts to public charities
  - Deduction limited to 30% of AGI for gifts to other charities
- Carry forward 5 years

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### Unused Charitable Deductions

- Take only on decedent's final return
- If final return is joint:
  - Calculate the charitable deduction separately for each spouse Treas. Reg. § 1.170A-10(d)(4)(i)
- Excess contributions are NOT available to the decedent's estate

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### Charitable Contribution Carryovers

- Charitable contribution carryovers also expire if not used by a taxpayer before death
- Reg. § 1.170A-10(d)(4)(i) provides that if the carryover is not used in the final joint return, the remaining carryover must be allocated between the spouses, and it provides the manner in which to allocate the carryover

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### Charitable Contribution Carryovers

- The taxpayer must allocate the amount by re-computing the contributions as if separate returns had been filed for the contribution year
- Any portion of the carryover allocated to the surviving spouse can be carried over to future years
- Any carryover allocated to the deceased spouse is lost if not used in the year of death

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### Other Carryovers

- Investment interest expense
- Foreign tax credits
- Alternative minimum tax (AMT) credit carryovers
- All must be allocated between the decedent and the surviving spouse, based on the spouse who generated the credit
- Any carryovers attributable to the decedent are permanently lost after the decedent's year of death

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### § 454 Election

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### § 454 Election for Savings Bonds

- Making an election under § 454(a) of the tax code and Rev. Rul. 68-145 allows the interest accrued through the date of death as taxable income on the decedent's final return
- Individuals who own series E or EE U.S. Savings Bonds (and HH bonds received in a tax-free exchange for E or EE bonds) normally do not elect to annually report the increase in the redemption price of these bonds as taxable income
- If a decedent did not make this election, the personal representative of the estate may do so and the previously unreported interest on the bonds will be included in gross income on the decedent's final income tax return

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### What Are the Benefits?

- This election presents a good planning opportunity for accelerating income on the decedent's final return
- This election also should be considered to take advantage of the lower tax rates on the decedent's final return if:
  - (1) the bonds are payable to the estate, with its very high tax rates; or
  - (2) the beneficiaries of the estate (or the designated beneficiaries of the bonds) are in a higher tax bracket than the decedent

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### Other Outcomes and Rules

- If the election is made, it must be made for all such bonds
- If the IRC § 454(a) election is not made, the unreported interest is considered income in respect of a decedent (IRD), taxable to the estate or beneficiary under IRC § 691(a)
- One advantage of not making this election is that the personal representative will have the ability to redeem the bonds over a period of several taxable years, potentially reducing the income tax consequences of the redemptions
- Regardless of whether this election is made, the bonds are includible in the decedent's gross estate at a value equal to the sum of the principal and accrued interest through the date of death

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### Making the Election

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- A personal representative of an estate can elect to report all the accrued interest up to the date of death on the decedent's final income tax return
- Then, when an heir redeems the bonds, the only interest to report will be the interest that has accrued from the date of the decedent's death
- The election is also available if the savings bonds were held in a revocable trust at the time of the decedent's death

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### Making the Election

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- ELECTION TO ACCRUE U.S. SERIES E BOND INCOME (RECOGNITION ON DECEDENT'S FINAL INCOME TAX RETURN) PURSUANT TO INTERNAL REVENUE CODE §454(a) AND REG. §1.454-1(a)
- The undersigned, Executor(s)/Administrator(s) of the above-referenced Estate, hereby elects under Internal Revenue Code §454(a) to recognize all previously unreported U.S. Series E Bond interest income in this decedent's final income tax return (Form 1040)

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### Making the Election

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- This election must be made on a timely filed return (due date including extensions) or on an amended return
- Rev. Rul. 55-655, 1955-2
- However, the election cannot be made on an amended return filed after the expiration of the statutory period for filing the original return

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IRS Issues



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Getting Information from IRS

- Some or all of the information you need, may be in the decedent's personal records
- If not, you will need to request information from the IRS, and they need to know that you are authorized to receive it

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Getting Information from IRS

- To establish that you are properly authorized to receive tax information of a decedent or their estate, submit the following with the information request:
  - The decedent's complete name, address and social security number
  - A copy of the death certificate, and either
    - A copy of Letters Testamentary approved by the court, or
    - IRS Form 56, Notice Concerning Fiduciary Relationship, if there is no court proceeding

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## Signature – Form 8822

- The estate administrator, executor or an authorized representative must sign
- If the last return was a joint return, the spouse must also sign
- Unless the taxpayer has indicated by checking the box on line 1 that they are establishing a separate residence

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## Separate Residence

Form **8822**  
(Rev. October 2015)

### Change of Address

(For Individual, Gift, Estate, or Generation-Skipping Transfer Tax Returns)

OMB No. 1545-1183

Department of the Treasury  
Internal Revenue Service

► Please type or print. ► See instructions on back. ► Do not attach this form to your return.  
► Information about Form 8822 is available at [www.irs.gov/form8822](http://www.irs.gov/form8822).

#### Part I Complete This Part To Change Your Home Mailing Address

Check all boxes this change affects:

- 1 ☐ Individual income tax returns (Forms 1040, 1040A, 1040EZ, 1040NR, etc.)  
► If your last return was a joint return and you are now establishing a residence separate from the spouse with whom you filed that return, check here ☐
- 2 ☐ Gift, estate, or generation-skipping transfer tax returns (Forms 706, 709, etc.)  
► For Forms 706 and 709-NR, enter the decedent's name and social security number below.
- Decedent's name \_\_\_\_\_ ► Social security number \_\_\_\_\_

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## Form 1310

Form **1310**

### Statement of Person Claiming Refund Due a Deceased Taxpayer

OMB No. 1545-0047

Department of the Treasury  
Internal Revenue Service

► Information about Form 1310 is available at [www.irs.gov/form1310](http://www.irs.gov/form1310).

Tax year decedent was due a refund:

Decedent year \_\_\_\_\_ or other tax year beginning \_\_\_\_\_ and ending \_\_\_\_\_  
Name of person claiming refund \_\_\_\_\_ Date of death \_\_\_\_\_ Decedent's social security number \_\_\_\_\_  
Please print or type  
Name (include number and street). If you have a P.O. box, see instructions. \_\_\_\_\_ Your social security number \_\_\_\_\_  
City, town or post office, state, and ZIP code. If you have a foreign address, see instructions. \_\_\_\_\_ Apt. no. \_\_\_\_\_

#### Part I Check the box that applies to you. Check only one box. Be sure to complete Part III below.

- A ☐ Surviving spouse requesting reimbursement of a refund check (see instructions).  
B ☐ Court-appointed or certified personal representative (see instructions). Attach a court certificate showing your appointment, unless previously filed (see instructions).  
C ☐ Person, other than A or B, claiming refund for the decedent's estate (see instructions). Also, complete Part II.

#### Part II Complete this part only if you checked the box on line C above.

- |   | Yes | No |
|---|-----|----|
| 1 Did the decedent have a will?   |     |    |
| 2a Has a court appointed a personal representative for the estate of the decedent?  |     |    |
| b If you answered "Yes" to 2a, will one be appointed?   |     |    |
| c If you answered "Yes" to 2a or 2b, the personal representative must file for the refund.  |     |    |
| 3 As the person claiming the refund for the decedent's estate, will you pay out the refund according to the laws of the state where the decedent was a legal resident?  |     |    |
| If you answered "Yes" to 3, a refund cannot be made until you submit a court certificate showing your appointment as personal representative or other evidence that you are entitled under state law to receive the refund. |     |    |

#### Part III Signature and verification. All filers must complete this part.

I request a refund of taxes unpaid by or on behalf of the decedent. Under penalties of perjury, I declare that I have examined this claim, and to the best of my knowledge and belief, it is true, correct, and complete.

Signature of person claiming refund \_\_\_\_\_ Date \_\_\_\_\_

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### Surviving Spouse

#### Line A – Check Reissuance Only

- Check the box on line A if you received a refund check in the surviving spouse's name and the deceased spouse's name
- Return the joint-name check with Form 1310 to the local IRS office or the Internal Revenue Service Center where the return was filed
- A new check will be issued

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### Line C Form 1310

- Check the box on line C if the taxpayer is not a surviving spouse claiming a refund based on a joint return and there is no court appointed personal representative
- They must also complete Part II
- If they check the box on line C, they must have proof of death
- The proof of death is a copy of either of the following:
  - The death certificate, or
  - The formal notification from the appropriate government office (for example, Department of Defense) informing the next of kin of the decedent's death
- Do not attach the death certificate or other proof of death to Form 1310
- Instead, keep it for a record and provide it if requested

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### Form 1310

- Form 1310 is used to match the taxpayer claiming the refund with the deceased
- It also provides information on whether a will was left
- States have different rules regarding the pay out of the refund
- By submitting the form, the taxpayer agrees to abide by the applicable state law

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## Tips

- Always file Form 1310 if a refund is present on a decedent's final return
- The final return can be a waiting process
- The personal representative/executor must often wait until the final year of death tax forms are available for filing
- **DO NOT** cross through a current year return and place the final year of death
- IRS cannot process for example 2017 return until the computers have been programed in later December 2017 – January 2018

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## It Is A Waiting Game

- You cannot file the final Form 1040 until the forms are released for the year of death
- **DO NOT CROSS THROUGH A 2016 RETURN AND WRITE IN 2017**

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## States May Have Their Own Form 1310

Illinois Department of Revenue  
**IL-1310** Statement of Person Claiming Refund Due a Deceased Taxpayer  
 For calendar year \_\_\_\_\_ or fiscal year ending \_\_\_\_\_ IL Attachment No. 22

**Step 1: Provide the claimant's information**

1 Claimant's Social Security or Federal Employer's Identification number \_\_\_\_\_

2 Claimant's name \_\_\_\_\_

3 Street address \_\_\_\_\_

4 City, State, ZIP \_\_\_\_\_ Daytime phone number \_\_\_\_\_

5 I am filing this statement as (check only one box)  
☐ surviving spouse claiming refund on behalf of deceased spouse's separate tax return.  
 (Complete Schedule A and attach proof of death.)  
☐ deceased taxpayer's personal representative.  
 (Attach a court certificate showing your appointment.)  
☐ other claimant for the estate of the deceased taxpayer.  
 (Complete Schedule A and attach proof of death.)

I hereby request the refund of taxes overpaid by, or on behalf of, the deceased taxpayer and declare under penalties of perjury that I have examined this claim, and, to the best of my knowledge and belief, it is true, correct, and complete.

Signature of claimant \_\_\_\_\_ Date \_\_\_\_\_

IL-1310 (9-10-15) **Return only the top portion**

**Step 2: Provide the deceased taxpayer's information**

6 Deceased taxpayer's Social Security number \_\_\_\_\_ Date of death \_\_\_\_\_

7 Deceased taxpayer's name \_\_\_\_\_

8 Street address (permanent residence or domicile at date of death) \_\_\_\_\_

9 City, State, ZIP \_\_\_\_\_

**Schedule A**  
 Complete only if "Box a" or "Box c" is checked in Step 1, Line 5.  
 1 Did the deceased leave a will? yes ☐ no ☐  
 2 a Has a personal representative been appointed? yes ☐ no ☐  
 b If "no," will one be appointed? yes ☐ no ☐  
 If "yes" is checked for 2a or 2b, do not file this form.  
 The personal representative should file for the refund.  
 3 Will you, as the claimant for the estate of the deceased taxpayer, distribute the refund according to the law of the state in which the deceased taxpayer maintained a permanent residence? yes ☐ no ☐  
 If "no," do not file this form until you can submit proof of your appointment as the deceased taxpayer's personal representative or other evidence showing that you are authorized under state law to receive payment.

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### When can I Expect the Estate Tax Closing Letter?

- For all estate tax returns filed on or after June 1, 2015, estate tax closing letters will be issued only upon request by the taxpayer
- Please wait at least four months after filing the return to make the closing letter request to allow time for processing. To request a closing letter please call (866) 699-4083 and provide the following information:
  - Name of the decedent
  - Decedent's social security number
  - Date of Death
- The closing letter will be prepared and issued to the executor at the address of record
- For any additional questions about estate tax closing letter requests or the status of the return, call (866) 699-4083

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### For estate tax returns filed before June 1, 2015

For estate tax returns filed after January 1, 2015 and before June 1, 2015		
If...	And...	Then:
The filing threshold was met	<ul style="list-style-type: none"> <li>• No portability election was made; or</li> <li>• The portability election not denied; or</li> <li>• The portability election was denied due to a late filing</li> </ul>	A closing letter will be issued
The filing threshold was not met	<ul style="list-style-type: none"> <li>• No portability election was made; or</li> <li>• The portability election was not denied</li> </ul>	A closing letter will be issued
	The portability election was denied due to a late filing	No closing letter will be issued
The return was filed pursuant to Rev. Proc. 2014-18	The portability election was not denied	A closing letter will be issued
	The portability election was denied due to failure to meet the requirements	No closing letter will be issued

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### Is There an Alternative to the Estate Tax Closing Letter?

- Yes
- Account transcripts, which reflect transactions including the acceptance of Form 706 and the completion of an examination, may be an acceptable substitute for the estate tax closing letter
- Account transcripts are available online to registered tax professionals using the Transcript Delivery System (TDS) or to authorized representatives making requests using Form 4506-T

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## Summary

- Prepare and file the final return
- Verify all prior year returns have been filed
- Income earned up to the date of death applies to the Form 1040
- Income earned after the date of death belongs on a Form 1041, generally
- The taxpayer is entitled to all deductions, paid before death, and credits

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## Deceased Taxpayers – Protecting the Deceased's Identity from ID Theft

- Each year, thieves steal the identities of nearly 2.5 million deceased Americans
- The information below provides a few tips to reduce the risk of having a deceased person's identity stolen:
  - Send the IRS a copy of the death certificate, this is used to flag the account to reflect that the person is deceased
  - Send copies of the death certificate to each credit reporting bureau asking them to put a "deceased alert" on the deceased's credit report
  - Review the deceased's credit report for questionable credit card activity
  - Avoid putting too much information in an obituary, such as birth date, address, mother's maiden name or other personally identifying information that could be useful to identity thieves

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## The Scoop – Upcoming Dates

- August 2
- August 16
- August 30
- September 13
- October 4
- October 18
- November 1
- Held at 8:00 am and 12:00 pm Central time

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### CALT Website

<http://www.calt.iastate.edu/>

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### Tour of the CALT Website



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### Up Coming Webinars

<http://www.calt.iastate.edu/calendar-node-field-seminar-date/month>

- Reconstructing Records for Tax Compliance August 17
- Uber/Lyft Drivers and Business Expenses August 22
- Tax Reform and New Law Update October 17
- New Partnership Audit Rules October 19

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### Upcoming Seminars – Mark Your Calendar – Final Dates

- September 21, 2017 Ag Law Seminar, Live and Webinar
- September 22, 2017 Farm and Estate Tax Review, Live and Webinar
- Retirement and Social Security Issues(Webinar) = October 10-11, 2017

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### The Schedule is Finalized for the 44th Annual Federal Income Tax Schools

- November 2-3, 2017 – Maquoketa, Iowa – Centerstone Inn and Suites
- November 6-7, 2017 – Le Mars, Iowa – Le Mars Convention Center
- November 8-9, 2017 – Atlantic, Iowa – Cass County Community Center
- November 9-10, 2017 – Mason City, Iowa – North Iowa Area Community College
- November 16-17, 2017 – Ottumwa, Iowa – Indian Hills Community College
- November 20-21, 2017 – Waterloo, Iowa – Hawkeye Community College
- December 11-12, 2017 – Ames, Iowa and Live Webinar – Quality Inn and Suites

Center for Agricultural Law &amp; Taxation

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