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Fiduciary Representation in Pre-Litigation Estate and Gift Tax Controversies

Frank Agostino, Esq.
Lawrence A. Sannicandro, Esq.

Author Contact Information:

Frank Agostino
Agostino & Associates, P.C.
Hackensack, NJ
Fagostino@agostinolaw.com
(201) 488-5400

Lawrence A. Sannicandro
McCarter & English, LLP
Newark, NJ
LSannicandro@mccarter.com
(973) 639-2081

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I. Introduction

Estate and gift tax returns filed with the Internal Revenue Service (“Service”) *will* be reviewed and classified for audit potential. Estate and gift tax audits return for tax authorities more dollars per capita than any other subdivision of tax, and as such, audits in estate and gift tend to be emphasized. These auditors are most typically lawyers who are well-versed in cutting-edge planning techniques. Anecdotally, gift tax return audits have been rare. That may soon change if, as is currently being proposed in connection with ongoing tax reform efforts, the estate tax is repealed or the applicable exemption amount is increased. If the estate tax is eliminated or the applicable exclusion amount is increased, then the Internal Revenue Service (“Service”) may emphasize the audits of gift tax returns with greater frequency than it has historically done.

For these reasons, in addition to the fact that it is our duty to file tax returns that are true, correct, and complete as to every material fact, estate planners and return preparers preparing estate and gift tax returns must be mindful of the audit at all stages of the estate planning process - from estate planning to estate and gift tax return preparation. And, at the same time estate planning is concerned with how to settle a person’s estate post-death, issues from the decedent’s life may plague the estate even after the decedent’s passing. More recently, these issues have concerned unfiled gift tax returns, foreign bank account reporting requirements, residency audits, and lingering income tax deficiencies, just a few of the many topics covered in this outline. This outline advises readers on how to effectively deal with these issues and proven methods by which clients can be protected from unnecessary fiduciary and transferee liability.

NOTE: At the time this Outline is being written, both chambers of Congress have proposed changes to the federal estate and gift tax in connection with tax reform. The authors will discuss during their presentation the various ways in which then-pending tax legislation will affect estate and gift tax audits going forward.

II. Prepare Estate and Gift Tax Returns With the Audit in Sight

A. Filing the Federal Estate Tax Return

1. When Required or Otherwise Advisable to File:

- a. When Required: The personal representative of an estate generally must file Form 706, *United States (and Generation-Skipping Transfer) Tax Return*, in all cases where the gross estate on the date of death exceeds the basic exclusion amount in effect under I.R.C. § 2010(c) (\$5.49 million for 2017). As a general rule, the Form 706 must be filed any time within nine months after the decedent's date of death. See I.R.C. § 6075(a).
- b. Otherwise Advisable to File: With the permanency of portability in 2012, it is generally advisable to file a Federal estate tax return even though one might not otherwise be required. Portability can only be elected on a *timely-filed, complete, and properly prepared estate tax return* of the predeceased spouse whose exemption is intended to be used, regardless of whether the estate of the predeceased spouse is otherwise required to file a tax return. In other words, to claim the predeceased spouse's exclusion amount for the surviving spouse, the personal representative of the predeceased spouse will need to file an estate tax return even if the predeceased spouse's estate is not taxable. For surviving spouse's who could conceivably have a taxable estate, it is therefore a best practice to file a Federal estate tax return to preserve the availability of the deceased spouse's unused exclusion (*i.e.*, his or her DSUE). See I.R.C. § 2010(c)(5).

2. Extension of Time to File Estate Tax Return: I.R.C. § 6081 provides for the extension of time to file an estate tax return. See I.R.C. § 6081(a).

B. Filing the Federal Gift Tax Return

1. Filing Requirements

- a. When Required: Generally, I.R.C. § 6019 requires a U.S. federal gift tax return to be filed by any individual who, subject to certain exceptions, makes a transfer by gift which (i) does not qualify for the marital deduction, (ii) does not qualify for the charitable deduction, (iii) is greater than the I.R.C. § 2503(b) annual exclusion amount of \$10,000 as adjusted for inflation, or (iv) is not a qualifying medical or educational expense. A gift tax return is made on a Form 709, *United States Gift (and Generation-Skipping Transfer) Tax Return*.
- b. When Due:
 - (1) In General: As a general rule, gift tax return must be filed

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"Dealing with a Decedent's Fraud: Cleaning up Our Dead Client's Bad Behavior"