Blanche Lark Christerson
Managing Director, Senior Wealth Planning Strategist

Tax Topics

2016-01

01/28/16

A potpourri

This issue of *Tax Topics* addresses a variety of tax-related points, meaning that recent developments are sparse. All eyes seem to be on the presidential campaign, where there is no shortage of back and forth. As to taxes, Democratic candidates are largely echoing President Obama's more recent proposals, including imposing the so-called "Buffett Rule," whereby individuals with $1 million or more of income would pay at least 30% in total taxes on that income, and reverting to the 2009 transfer tax parameters ($3.5 million exclusion against estate tax and generation-skipping transfer tax, $1 million gift tax exclusion and a top rate of 45%). Republican proposals vary, but generally call for lowering income tax rates and broadening the tax base, and likely eliminating the estate tax. What will happen? No one knows, of course – but it certainly won't be dull!

Loss of U.S. passport for "seriously delinquent" taxes

One of the revenue offsets in the "Fixing America's Surface Transportation Act," (Pub. L. 114-94), which was enacted on December 4, 2015, is bad news for taxpayers with "seriously delinquent tax debt." That is, effective immediately, if the taxpayer owes more than $50,000 in unpaid taxes, including penalties and interest, the taxpayer's passport can be revoked or denied (as in a renewal) if the IRS certifies the delinquency to the Department of State (the $50,000 number will be indexed for inflation). For this new rule to apply, the IRS must have a) filed a lien against the taxpayer and all administrative remedies have been exhausted, or b) levied on the taxpayer's property. Presumably this means that if, for example, there is ongoing litigation over a tax controversy and big dollars are at play, the new rule does not apply because all remedies have not yet been exhausted. Certain exceptions exist, including if the affected taxpayer has an emergency or for "humanitarian reasons," but this is one more arrow in the government's quiver for tax enforcement – and it's serious.

Basis reporting forms

Last summer, the Highway Trust Fund received a short-term cash infusion from legislation that also imposed new basis reporting requirements on estate executors. These requirements apply to estate tax returns filed on or after August 1, 2015, and mandate that within 30 days of filing an estate tax return, an executor file a statement, with both the IRS and estate beneficiaries, detailing estate property and its value. Because the first statements would have been due at the end of August 2015 (generally relating to people who died in the fall of 2014), the IRS issued a reprieve on August 21, 2015: Notice 2015-57 instructed executors to wait until February 29, 2016 to file anything that might otherwise be due, so as to give the IRS time to develop forms and guidance.

To that end, on December 18, 2015, the IRS issued draft Form 8971, "Information Regarding Beneficiaries Acquiring Property from a Decedent"; on January 6, 2016, draft instructions for the form were sent to the Office of Management and Budget for review. The Form 8971 includes a Schedule A, which is to be submitted to each beneficiary receiving property from the decedent's estate.

The draft instructions address certain questions that have been raised about basis reporting, such as what if the executor doesn't know within 30 days of filing the estate tax return exactly how the residuary estate (what's left over after taxes and expenses) will be divided among the residuary beneficiaries? The answer is that the executor must complete a Schedule A for each beneficiary "that acquired (or is expected to acquire) property from the estate." And if, by the deadline for Form 8971, the executor hasn't yet determined who gets what, the executor must list on that beneficiary's Schedule A "all items of property that could be used, in whole or in part, to fund the beneficiary's distribution." (In other words, do your best, executor.)

The instructions do *not* address a number of questions that have been raised, including:

- If the decedent's estate is under the current $5.45 million filing threshold for estate tax returns, but the executor files one anyway so that deceased spouse's unused exclusion amount carries over to the surviving spouse (a "portability" return), must the executor still file the Form 8971?
- If beneficiaries receive cash (it has no basis) or assets that do not receive a basis adjustment (such as annuities or retirement accounts), is basis reporting required?

Putting aside the unanswered questions, the instructions detail the potential penalties for failing to file a correct Form 8971 by the due date. If it is filed within 30 days *after* the due date, the penalty is $50 per Form 8971, with a maximum penalty of $500,000 per year, or $175,000 if the taxpayer qualifies for lower penalties; if it is filed *more than* 30 after the due date, the penalty is $250, with a maximum penalty of $3 million, or $1 million if the taxpayer qualifies for lower penalties. (Yes, those are really the numbers.)

The point is that there are still many unknowns about proper basis reporting, and the penalties for failing to properly report are real. February 29th, the postponed initial due date, is just around the corner. Fingers crossed that the IRS will issue an additional postponement so as to iron out some of these issues.

You can't delegate that!

Mo Vaughan was a major league baseball player from 1991 to 2003. In 2004, he hired Ra Shonda Kay Marshall and her company, RKM Business Services, to manage his financial affairs, including investing his money, paying his taxes and bills, and doling out money to him. Vaughan gave Marshall expansive powers, along with a durable power of attorney; he also hired an accountant to prepare and file his tax returns. In 2004, 2005 and 2006, Marshall properly filed Vaughan's returns, but only his 2004 and 2005 taxes were properly paid. In 2007, Marshall neither filed nor paid Vaughan's taxes. In late 2008, Vaughan decided to manage his financial affairs himself, and terminated the arrangements with Marshall and the accountant. Upon reviewing his bank statements, Vaughan realized that Marshall had been cheating him for years – she embezzled from his accounts and failed to pay his taxes. In fact, when Vaughan's 2007 taxes were due, his accounts were so depleted that he could not cover the liability. Vaughan sued Marshall and her company and has outstanding judgments against them totaling $5 million.

…in the meantime, what about the IRS? Unsurprisingly, it caught up with Vaughan, and assessed late filing penalties against him for his 2006 and 2007 taxes. Vaughan apparently paid what was owed, and then sued to recover the penalties. He advanced the following arguments: 1) because he used ordinary business prudence and care in selecting his agents and instructing them to file and pay his taxes, he should not be held responsible for his agents' violating his specific instructions and disregarding their fiduciary duties; and 2) because his agents had unfettered power to file and pay his taxes, their fraud and embezzlement left him unable to file and pay.

And what did the court say? "Neither argument has merit." As to the first argument, a deadline is a deadline, and the taxpayer is responsible for seeing that the taxpayer's obligations are met. As to the second, the malfeasance of Vaughan's agents did not excuse his lack of oversight in ensuring the timely filing and payment of his own taxes; Vaughan's inability to pay his taxes did not result from a force beyond his control.

The moral of the story? Certain duties simply cannot be delegated. Even if a taxpayer hires someone "to take care of things" – as in filing and paying taxes on behalf of the taxpayer – the taxpayer is still ultimately responsible for making sure that this gets done. Ignoring that responsibility means that a plea to abate a late filing penalty for "reasonable cause" will likely fall on deaf ears. *Vaughan v. United States of America,* No. 14-3858, 6th Circuit Court of Appeals, Dec. 15, 2015.

Alaska income tax possible?

Alaska is currently one of seven states that does not tax an individual's income (the other states are Washington, Wyoming, Nevada, Texas, South Dakota and Florida; Tennessee and New Hampshire only tax interest and dividend income). Yet Alaska, like other states that have long benefited from oil production revenues and related taxes, is feeling the pain from lower oil prices; to address the budget shortfall the state is facing, legislation has been introduced in the Alaska House of Representatives that would reimpose an income tax on an individual's income (see 2015 AK H 250). The last time Alaska had such a tax was about 35 years ago. The legislation's prospects are unknown, but it is interesting to note that while lower oil prices benefit drivers, for example, when they fill up their gas tanks, those lower prices can have serious fiscal repercussions for state governments.

A slight breather

The usual due date for income tax returns is April 15th of the following year. So although a taxpayer's 2015 income tax return would normally be due on April 15, 2016, this year it is due on Monday, April 18, 2016 because Emancipation Day is observed in Washington, D.C. on April 15th. In addition, taxpayers living in Maine and Massachusetts have until April 19, 2016 to file their returns because Patriot's Day (a holiday in these two states) falls on April 18, 2016. Of course, taxpayers who instead file for an automatic six-month extension on or before these dates have even longer to file their taxes – understanding, however, that an extension to file is NOT an extension to pay: even if they are on extension, taxpayers still must pay the balance of what they believe they owe for their 2015 taxes by the applicable April 2016 due date.

February 7520 rate

The IRS has issued the February 2016 applicable federal rates: the February 7520 rate remains at 2.2%, where it was in January. The February mid-term rates are up just a hair: 1.82% (annual), 1.81% (semiannual and quarterly) and 1.80% (monthly). The January mid-term rates were: 1.81% (annual), 1.80% (semiannual and quarterly) and 1.79% (monthly).

Blanche Lark Christerson is a managing director at Deutsche Bank Wealth Management in New York City, and can be reached at blanche.christerson@db.com.