NEW YORK STATE BAR ASSOCIATION
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June 22, 2011

The Honorable Douglas H. Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

The Honorable William J. Wilkins
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington DC 20224

The Honorable Emily McMahon
Acting Assistant Secretary
(Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Re: Draft Form 8939, Allocation of Increases in Basis for Property Acquired From a Decedent; Reporting of Certain 2010 Generation-Skipping Transfers.

Mr. Shulman, Mr. Wilkins and Ms. McMahon:

We are writing to provide comments on the Internal Revenue Service Draft Form 8939, Allocation of Increases in Basis for Property Acquired From a Decedent (the "Form").[1] This Form has been drafted as the mechanism for executors of estates of decedents dying after December 31, 2009 but before January 1, 2011 to make an allocation of an increase in tax basis to certain of the assets of such estate in the event the executor has elected application of the modified carryover basis regime permitted under the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "Act"). While some of these or similar comments have also been presented by various Committees of the Real Property, Trust and Estate Law and Taxation Sections of the American Bar Association (the "ABA Committees"), we believe it important to emphasize certain of their comments, to address the informal response from the Internal Revenue Service (the "Service") to

[1] This letter may be cited as New York State Bar Association Tax Section, *Draft Form 8939, Allocation of Increases in Basis for Property Acquired From a Decedent* (Report No. 1241, June 22, 2011). The principal author of this letter was Laura Twomey. This letter represents solely the views of the New York State Bar Associations Tax Sections and Trust and Estate Sections and has not been reviewed by the Executive Committee or House of Delegates of the NYSBA.

those comments, and to present additional considerations. This letter represents the views of the New York State Bar Associations Tax Sections and Trust and Estate Sections, but has not been reviewed by the Executive Committee or House of Delegates of the NYSBA.

We are also writing to provide comments relating to the reporting of generation-skipping transfers (each, a "GST") made in 2010. While the Service has released forms and instructions for gifts made during 2010, trust distributions made in 2010 that are subject to GST tax, and trust terminations occurring in 2010 that are subject to GST tax, issues remain that we believe warrant additional guidance.

I. Draft Form 8939

1. Required Disclosures

The draft Form contemplates that all of the decedent's assets will be reported on the Form with information concerning the basis of such assets, even those assets to which no basis increase is allocated. It is not clear what will be required to report these assets and determine the basis thereof (including, as the ABA Committees have noted, the basis of personal items acquired over a decedent's lifetime whose basis may be unknown and/or difficult to determine). We therefore recommend that the Service provide guidance as to whether appraisals will be required to be attached to the Form and, additionally, whether de minimis rules (requiring disclosure of only those assets whose fair market value exceeds a certain threshold amount) will apply.

2. Allocation of GST Tax Exemption and Potential State Law Ramifications

While the Economic Growth and Tax Relief Reconciliation Act of 2001 provided that GST tax would not apply to generation-skipping transfers made after December 31, 2009, the Act reinstated GST tax for transfers made on or after January 1, 2010 and provided a GST tax exemption of $5 million. As the draft Form does not include a mechanism for allocating a decedent's unused GST tax exemption, it is not clear whether an estate electing carryover basis treatment would be required to file a Federal Form 706, in addition to a Form 8939, in order to accomplish such allocation.

Requiring such an estate to file a Federal Form 706 for this purpose, however, may have adverse (and we assume unintended) state tax significance. For example, in New York, because the determination of a decedent's gross estate for New York estate tax purposes is contingent upon the definitions and guidelines under the Internal Revenue Code for determining such amount for Federal purposes, if an estate files a Federal Form 706 in order to allocate a decedent's unused GST tax exemption but does not make a qualified terminable interest property election therein for Federal purposes, it will then be disqualified from making a separate state-only qualified terminable interest property election on the basis that a Federal Form 706 has already been filed. We cannot imagine that Congress intended to inflict such a hardship, particularly one that could have a disparate impact not necessarily linked to the relative size of an estate. We therefore strongly urge the Service to consider the Federal Form 706 and the Federal Form 8939 as mutually exclusive and accordingly to include a mechanism in the final Form for allocating a decedent's unused GST tax exemption (and to clarify what additional fillings, if any, will be required to effect such allocation).

3. **Availability of Spousal Basis Adjustment Allocation to Property Sold During Administration**

Code Section 1022(c) provides for a basis increase allocable to "spousal property."[2] We understand that, in response to comments received from the ABA Committees, the Service has stated that it believes it is constrained by statute in permitting allocation of this basis increase to only outright spousal transfers or qualified terminal interest property transferred to a spouse and has expressed its belief that, accordingly, such basis increase may not be available for allocation to property sold during administration before being distributed to a spouse.

While we acknowledge the statutory reference to "outright transfer property" and "qualified terminable interest property," we believe that it is logical to conclude that those references include references to property sold during administration where the proceeds of the sale of such property will ultimately be received by the decedent's surviving spouse or in which such spouse shall have a qualifying income interest for life. Indeed, it would seem illogical if the Act were interpreted to dictate a different income tax result based solely on the timing of such a sale vis-à-vis the filing of the estate's Form 8939.

Moreover, in interpreting these provisions, consideration must be given to the reality that the funding of spousal bequests has in many cases been delayed specifically due to the uncertainty of the law applicable to decedents dying in 2010 that has persisted for over a year and the fact that the relevant Form has been and continues to be unavailable for filing. It would be inequitable to award spousal basis adjustment allocations to estates having sufficient assets and/or liquidity to refrain from selling assets in order to pay bills and make interim distributions to the spouse while penalizing those smaller illiquid estates or estates with volatile assets where sales of assets became necessary before a final Form became available. For example, such an interpretation would penalize an estate comprised entirely or primarily of marketable securities or other volatile assets, where the executor performing his or her fiduciary duties would have an obligation (particularly given the recent unprecedented instability of the markets) to quickly marshal the assets and secure them for the surviving spouse by selling them promptly, particularly where there are estate obligations. By contrast, a larger estate or one comprised of less volatile assets would not be impacted to the same degree. The result of this interpretation therefore is that a surviving spouse in the former example would be precluded from taking advantage of the spousal basis adjustment when calculating capital gains on the securities sales based purely on the unlucky happenstance that a final Form on which to allocate such basis adjustment was not yet available before such sales became necessary (to pay debts, or to make distributions for the spouse's living expenses) or prudent (to protect against losses).

With due respect for the very difficult issues raised by the carryover basis regime, we note that it is quite understandable that developing the Form and resolving the many novel considerations raised by the new regime would take many months. The estates of those that passed away in the first half of 2010, however, have been in administration for a year to a year and half already with no ability to allocate the spousal basis adjustment due to the unavailability of the final Form. As a practical matter, there is only so long an estate may delay asset sales. Denying the basis adjustment for assets sold before the Form becomes available results in a frustration of the Congressional intent behind providing the spousal basis adjustment in the first place, given that the more time that elapses before the final Form is issued, the greater the number of assets that will have to be sold by such estates without the benefit of the spousal basis adjustment.

[2] References to the "Code" refer to the Internal Revenue Code of 1986, as amended.

Indeed, the very provision for a spousal basis adjustment allocation in the Act demonstrates a Congressional intent to lessen the impact of the carryover basis regime with respect to surviving spouses; it therefore does not follow that Congress intended to inflict a less favorable tax result on those estates requiring the immediate liquidation of certain assets, whether to raise money to pay expenses, or to dispose of a home that could not be supported without decedent's earnings, or the like. Furthermore, Congress must have contemplated the possibility of sales of assets during administration as liquidity needs often arise during the administration of an estate, and yet nothing in the Act or legislative history indicates that the spousal basis adjustment should not be available with respect to spousal property sold before the Form is filed. We therefore hope the Service will permit the basis increase to be allocated to such assets.

4. **Clarification of the Availability of Increase in Basis for Property Included in Decedent's Estate Pursuant to I.R.C. 2044**

Code Section 1022, regarding the treatment of property acquired from a decedent dying after December 31, 2009, provides that the tax basis of property acquired from a decedent may be increased subject to the rules and limitations provided in such Section. Specifically, Code Section 1022(d)(1)(A) provides that "[t]he basis of property acquired from a decedent may be increased under subsection (b) or (c) only if the property was owned by the decedent at the time of death" (emphasis added). While Code Section 1022(d)(1)(B) provides some clarification as to certain property included in a decedent's estate but not considered "owned by the decedent at the time of death" for purposes of allocating basis increases, it is not clear whether property included in the decedent's estate by virtue of Code Section 2044 would be deemed to have been "owned by the decedent at the time of death" for such purposes. Accordingly, this issue warrants clarification. Specifically, we recommend that the Service clarify that property included in the decedent's estate by virtue of Code Section 2044 may be deemed to have been "owned by the decedent at the time of death" for the purposes of availability of the basis increase as we believe this clarification would be consistent with the logic behind the provisions concerning applicability to jointly held property, community property, and property held in revocable trusts.

5. **Due Date and Extension Availability**

We recommend that, at such time as the Service provides a final Form and clarifies the filing due date for the form, that the Service also clarify the guidelines and mechanism, if any, for requesting and receiving an extension of such due date. As not all state filing deadlines have been extended or confirmed to be dependent on Federal filing deadlines, estates would benefit from the availability of the Final form with accompanying guidance and confirmation of the filing deadline as soon as possible.

II. 2010 Generation-Skipping Transfers

1. **Application of Automatic Allocation of GST Exemption**

As described above, although the Economic Growth and Tax Relief Reconciliation Act of 2001 provided that GST tax would not apply to generation-skipping transfers made after December 31, 2009, the Act reinstated GST tax for transfers made on or after January 1, 2010, but assigned a zero percent tax rate. Code Section 2632 provides for the automatic allocation (absent an affirmative "opt-out" by the taxpayer) of GST tax exemption to outright direct skips and direct skips to certain trusts. While the policy judgment behind Code Section 2632 is logical in the context of an affirmative applicable tax rate, the assumption of the desirability of automatic allocation may be inaccurate in the context of a zero percent applicable GST tax rate. In light of the zero percent GST tax rate applicable to outright direct skips and direct skips to

certain trusts made in 2010, taxpayers who made such transfers may not be aware of the potential for automatic GST exemption allocation to such transfers, which would yield no tax benefit. Accordingly, we recommend that the Service clarify whether an election out of automatic GST exemption allocation will be required for 2010 GST transfers to which the zero percent tax rate applies and, further, whether the filing of amended returns will be permitted for those taxpayers who filed a gift tax return on April 18, 2011 without the benefit of any such clarification.

2. **Adequate Disclosure**

The instructions to Form 709 for gifts and generation-skipping transfers made in 2010 explain the requirement that a gift must be adequately disclosed in order to trigger the running of the statute of limitations and they further describe the requirement of supplying certain information regarding the gift, including providing either a qualified appraisal or a detailed description of the method used to determine the fair market value of the gift (referencing Code Regulations Section 301.6501(c)-1(e) and (f)).

In the case of a trust distribution or termination occurring in 2010 that is subject to GST tax (but not gift tax), the tax rate will be zero, and therefore the necessity of providing such information is unclear; as the GST tax will in any event be zero, the process of gathering and providing information related to the fair market value of the property, including an appraisal or other determination of value, seems needlessly onerous. Nevertheless, the instructions to the Form 706-GS(D) and Form 706-GS(T) applicable to such transactions direct the filer to "explain how reported values were determined and attach copies of any appraisals." We therefore request additional guidance on this issue.

Sincerely,

Jodi J. Schwartz, Chair