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Fraud, Omissions, Errors, and Missed Deadlines: Dealing with the Troublesome 706



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Transfer Tax System

The Transfer Tax System does not appear to be working, consider:

- In 2010 the IRS issued summons to several states asking for all “gift” deeds to compare with filed 709’s, only some states complied but Ohio did and the IRS found zero compliance.
- The Estate Tax for 2012 yielded only \$ 12.3 Billion, or .5% of all federal tax collections. For the same period, the Gift Tax produced \$2.1 Billion, for .1%.
- During FY 2010 only 15,000 706’s were filed, with less than half tax due.
- Yet the Federal Reserve estimated Household Net Worth to be \$56.8 Trillion dollars as of the 4th quarter, 2010.
- You may recall some particularly fanciful IRS congressional testimony from a few years back claiming that the intergenerational wealth transfer from the World War II generation would retire the (then smaller) national debt.

Transfer Tax System

My point being that even a cursory review of the wealth transfer tax system indicates it is full of holes:

- We have no way of tracing intergenerational land transfers:
 - In most states, the land titling process is decentralized;
 - No formal connection between the probate process and the tax assessment function;
 - Not uncommon for family land to be titled in ancestor's names simply through inertia.
- No real method of detecting gifts other than audit;
- Untitled wealth; like gold bullion, cash, art work, etc. can flow from generation to generation undetected.

Transfer Tax System

So the IRS should be concentrating audit resources here:

- After all, Revenue Agents working in the Transfer Tax area are traditionally the second most productive of all auditors; right behind Large Case Corporate groups.
- But they're not.
 - About 200 agents nationwide.
 - Audit coverage for 706's (2012) was 29.9%, and for the same period 709's were an abysmal 1.4%.
 - Consider in my 30 year plus career in tax litigation, I have only seen 3 transfer tax criminal cases, of which only 1 moved to prosecution (plead out as failure to file a gift tax return as part of settlement).

Transfer Tax System

I am not suggesting non-compliance; just pointing out the difficult position, as practitioners, are in. We have to comply with the law, in the face of pervasive non-compliance.

And we all have stories...

Scenario: Omitted Asset(s)

After filing the 706 you discover/have revealed to you, that a material asset was left off the return. Assume statute of limitations is open.

- Determine why/how it was left off.
 - Overlooked.
 - Mistake of fact or law.
 - Concealed.
 - Intentionally omitted.

Scenario: Omitted Asset(s)

If it's intentionally omitted you have a problem:

- Get your nomenclature right – was it fraudulently omitted i.e., did the Taxpayer (Executor) “intentionally intend to defraud the government?”
- It may be just plain old fashioned intra-family embezzlement, where the intent was to beat the sibling out of the value and tax savings was just an added benefit.
- Response:
 - Hire an attorney for You.
 - Segregate and preserve your files.
 - Notify the client in writing.
 - Recommend the client hire an attorney.
- His attorney may recommend he do a voluntary disclosure by filing a corrected return, and you may want to participate in that process. This leaves open the question of your continuing the representation.

Scenario: Omitted Asset(s)

What if the omission was unintentional?

- This happens a lot.
- The question now becomes whether you amend the 706.

Scenario: Omitted Asset(s)

Surprisingly you are under no legal obligation to do so.

Scenario: Omitted Asset(s)

How does this change if we have a 709, Gift Tax Return instead of a 706, Estate Tax Return?

- I think the gift tax return is more complex, if a 706 will be filed, because you must recalculate gift taxes in that filing.

Scenario: State Litigation

A surprisingly common situation is state litigation involving the estate with the CPA either unsure what assets are owned or fear that any filed return will be discovered and used as evidence. The temptation is delay the filing of the return.

- An estate gets a single 5 month extension; no more.
- Response:
 - You have to file.
 - Disclose, disclose, disclose.
 - Ambiguity as to ownership may work to your advantage since doubt as to title may justify discount.

Delinquency Penalties

- Failure to file – Section 6651(a)(1) - 5% per month, to a maximum of 25%. Given the dollars involved in many estate tax cases this can be an impressive amount.
- Failure to pay – Section 6651(a)(2) - .5% per month, again to a 25% maximum with some offsets; unpleasant but not crippling.
- What if you really are unsure as to the amount of tax and lack funds to pay?
- Response:
 - File the extension request with a high tax estimate.
 - Pay what you can.
 - EVEN IF YOU DON'T PAY THE EXTENSION IS VALID. See Reg. § 1.6081-6(b).
 - The Failure to Pay Penalty will not apply so long as the estimate is right.
 - Make a protective § 6161 election.

Section 6161 Election

Section 6161(a)(2) – Extension of time to pay tax for “reasonable cause.”

- Requires submission of detailed financial data to show lack of liquidity; i.e., large land holdings, private stock, etc.
- May be good for 10 years.
- Interest continues to run.
- Good for regular estate tax, § 6161 installments and deficiencies (4 years).

Defending the Delinquency Penalty

Hard to do...

- *U.S. v. Boyle*, 469 U.S. 241 (1985).
- But see:
 - *Haywood Lumber & Mining Co. v. Comm.*, 178 Fed 769 (2nd cr. 1950).

Title 31 Section 3713(B)

“A representative of a person or an estate (except a trustee acting under Title 11) paying any part of a debt of the person or estate before paying a claim of the Government is liable to the extent of the payment for unpaid claims of the Government.”

Who Does It Apply To?

- That statute applies to an executor or Fiduciary, but can be applied much more broadly.
- Any person with possession and control of the debtor's property can be made liable.
- Note that liability is absolute – i.e., no requirement that the payment be made negligently, etc.

Paying Any Part of a Debt

- Note: there is no exception for payment in the ordinary course of business.
- No *de minimus* rule.

Unpaid Government Claim

Does the Representative Have to Have Knowledge of the Unpaid Government Claim?

- Yes, but courts are quick to find constructive notice.
- For example, corporate officers, directors and major shareholders are presumed to know about all outstanding claims.
- Some courts have used a “prudent man” standard.

Tax Claims

Tax Claims When Does a Tax Claim Arise?

- Some early case law saying that unfiled, un-assessed federal taxes were claims as of the date they were ascertainable.
- More recent case law indicates a claim may arise as early as the audit notice.
- Unquestionably a claim exists where taxes are self-assessed by filing.

Reliance Defense

- *Little v. Comm’r*, 113 T.C. 474 (1999), an executor without actual knowledge of any income tax claims received W-2s and 1099s. Those were turned over to the estate’s attorney, who advised no tax was due. The Tax Court ruled that there was no liability under 3713(B) – that reliance on the attorney satisfied the reasonable man standard.
- But, some cases find liability for state court ordered payments.

How Much is the Liability?

The representative is personally liable for the amount of the payment made, limited to the amount of the Government claim.

IRS Can Proceed Under Transferee
Liability Theory and § 3713(B)
Simultaneously.

IRS “High Net Worth Group”

- LB&I Global High Wealth Industry Group
 - Conduct an “enterprise analysis” by reviewing and analyzing related returns
 - Holistic audit techniques that examine the connections between various tax returns for different taxpayers
 - Abandoned the old fashioned “stovepipe” analysis that only focused on one taxpayer at a time for a new broad-based inter-relationship analysis

IRS “High Net Worth Group” Estate Planning

- LB&I High Net Worth Group IDR
 - ID any asset transfer to and/or sold utilizing estate planning to reduce potential estate tax obligations, including Family Limited Partnerships, Living Trust Agreements, Grantor Retained Annuity Trusts, Private Foundations, Community Foundations, Donor Advised Funds, Qualified Personal Resident Trusts, Charitable Remainder Trusts and/or Intentionally Defective Grantor Trusts

IRS “High Net Worth Group” Estate Planning

- LB&I High Net Worth Group IDR
 - ID all fees paid with regard to tax or estate planning
 - ID all assets transferred or sold to a charitable organization or foundation

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IRS Circular 230 Disclosure

Information included in these slides is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding any penalties under U.S. federal tax law, or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

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Mr. Ungerman's practice includes estate planning and family wealth transfers along with IRS controversy matters at all levels. The tax and estate matters in which Mr. Ungerman is involved are typically very complex from both a factual and legal perspective. These matters often require legal and accounting skills. Mr. Ungerman is also a Certified Public Accountant.

Mr. Ungerman works with the families on wealth preservation and transfer strategies. A major focus is on accomplishing family wealth preservation goals with an emphasis on the efficient transfer of family wealth to the next generation from a business and tax perspective. Mr. Ungerman is heavily involved in the defense of estate and gift plans in front of the IRS. In certain cases, Mr. Ungerman has the opportunity to work with families and their professionals, while a patriarch or matriarch is living in order to analyze potential IRS scrutiny of an estate. In other scenarios, Mr. Ungerman works with the professional team post-death to provide insight as to potential areas of interest by the IRS.

Mr. Ungerman is also involved in defending Taxpayers & issues against IRS inquiries and actions. The IRS defense practice covers Civil and Criminal Exams, Investigations and Trials. Many of Mr. Ungerman's Tax Controversy matters include an offshore component.

Prior to joining the firm in 1994, he was a civil prosecutor for the Internal Revenue Service, Dallas District Counsel office. He was also a Special Assistant United States Attorney for the Department of Justice in Dallas during his time as a civil prosecutor. Prior to becoming an IRS attorney of a special assistant U.S. attorney, he served as a law clerk to the Honorable Carolyn M. Parr at the United States Tax Court in Washington, D.C.

Mr. Ungerman is a frequent speaker on tax topics including exams, IRS estate tax strategies, tax shelter defense, recent tax legislation, IRS criminal tax investigation techniques, and state tax controversy issues. He has a blog on *Forbes IRS Watch*.

Mr. Ungerman was admitted to practice in Texas in 1990.