

**AUDIT ROULETTE:  
ROUND AND ROUND WE GO**

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## **I. INTRODUCTION, SCOPE AND DEFINED TERMS**

This paper is concerned primarily with the examination (i.e., audit) of Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return ("Form 706"). This paper is intended to be a general summary and non-technical discussion of the many issues and matters which the personal experiences of the writer have shown should be carefully considered both prior to the filing of the federal estate tax return and during its examination. With regard to the preparation of the return, the paper is not intended to replace the printed Instructions to Form 706, which are prepared by the Internal Revenue Service (the "IRS"), and a close review of those instructions is always highly recommended as the starting point in the preparation of any Form 706.

In general, this paper utilizes a chronological approach to the discussion of various problems or issues encountered by the practitioner and taxpayer in the same sequence such problems or issues might arise during the normal course of the preparation, filing and examination of Form 706. However, procedures pertaining to certain tax elections, installment payment of taxes, extensions, claims for refund and other important procedural issues have also been separately discussed in more detail in this paper.

As noted previously, the primary emphasis of the paper will be on Form 706, but most of the matters discussed herein will have equal application to the preparation, filing and examination of Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return ("Form 709"). Although this paper deals primarily with audit techniques and procedural, rather than substantive law issues, some discussion of substantive matters is necessarily required on occasion. You are advised that, except where specific statutory or regulatory authority or case law is cited, the opinions expressed in this paper are only the personal and professional opinions of the writer.

Unless otherwise indicated, all Section references in this paper are references to the Internal Revenue Code of 1986 (the "Code"), as amended, and the terms "Service" or "IRS" shall both refer to the Internal Revenue Service. Although agents or attorneys of the Service presently "examine" rather than "audit" returns, these terms have been used interchangeably throughout this paper. References to "IRM" will refer to the Internal Revenue Manual published by the Service. More specifically, references to "Estate and Gift Tax Handbook" will refer to IRM Handbook 4.3.8.

Previously, the Service published an "Examination Technique Handbook for Estate Tax Examiners" ("Technique Handbook"), old IRM 4350. The Technique Handbook contained a comprehensive summary of examination techniques and instructions to be employed by the Service's personnel in the audit of Forms 706 and Forms 709. Historically, it was used as both a training tool and as a day-to-day reference guide for examiners in the estate and gift tax area. At one time the Technique Handbook was available for purchase from the various tax publishing companies. Revisions and updates of the Technique handbook have been pending in the National Office for some time and the current Technique Handbook is somewhat dated. Nevertheless, occasional references are made in this paper to the old Technique Handbook, (Rev. 2-1988) because the writer believes it reflects audit techniques and methods developed and employed by the Service over a long period of time, and continuing to be employed today, in whole or in part.

With regards to any references in the paper to the Internal Revenue Manual or to any other IRS publications, a strong word of caution is warranted. The IRM and other IRS publications are currently undergoing extensive revisions due to the pending reorganization of the Service, and many of the references in this paper to those publications are likely to change over time.

## **II. RESTRUCTURING OF THE INTERNAL REVENUE SERVICE**

### **A. IRS RESTRUCTURING AND REFORM ACT OF 1998**

The IRS Restructuring and Reform Act of 1998 ("RRA '98") was enacted by Congress and will substantially reorganize and restructure the IRS. See Public Law No. 105-206, enacted on July 22, 1998, 105<sup>th</sup> Congress, 2d Session. The Service refers to this major restructuring as "modernization."

Although primarily driven by taxpayer and Congressional dissatisfaction with existing IRS performance and service (or more importantly, the actual or perceived lack thereof), a number of other related factors were probably also significant in the successful effort to restructure and reorganize the Service. For example, the total number of IRS employees is declining, and the IRS, as a governmental agency, is shrinking when compared to the economy as a whole. Enforcement revenues from audit and/or collection activities of the Service account for only approximately 2% of all of the tax revenues collected by the IRS. Consequently, with approximately 98% of the collected tax revenues coming from non-enforcement activities, the Service needs to give more attention and apply more resources to the areas of taxpayer service and assistance in the voluntary reporting and payment of taxes. The past tax strategies and business practices of the Service were to a large degree determined by, and constrained by, the existing organizational structure which is deemed outmoded and not in conformity with general business practices and strategies which have proven successful in other private and public sectors of the economy. Lastly, there have been in recent years increasing horror stories and criticism about "heavy-handed" enforcement activities (both audit and collection) which have undermined the support and reputation of the Service in the eyes of both the Congress and the public at large.

### **B. OLD IRS ORGANIZATION**

Since 1952, the Service has been organized and operated under a three-tier

geographic structure consisting of a national office, regional offices and district and other local offices. As a result of its 1995 reorganization, prior to the enactment of RRA '98, there have been a National Office, 4 designated geographic regions (Northeast, Southeast, Midstates and Western), 10 Service Centers (one located in Austin, Texas), 3 Computing Centers, and 33 District Offices, 3 of which are presently located in Austin, Dallas and Houston, Texas).

Under the old IRS structure, the processing of tax returns, the management of taxpayer accounts, and the audit and/or collection enforcement activities associated with such tax returns were all primarily based on a taxpayer's geographic location without much regard to either the type of tax return or the type of tax involved. This will no longer be the case.

### **C. NEW IRS STRUCTURE**

The RRA '98 directs the Commissioner of Internal Revenue ("Commissioner") to restructure the existing IRS by eliminating or substantially modifying the present three-tier geographic structure (national office, regional office, district and local field offices) and replacing it with an organizational unit structure that emphasizes functional "operating units" serving particular categories of taxpayers with similar needs. See Joint Committee on Taxation, Summary of the Conference Agreement of HR 2676. The IRS Restructuring and Reform act of 1998, (JCX-50-98R), June 24, 1998. The Commissioner of Internal Revenue will remain the Chief Executive Officer of the IRS and will continue to be appointed by the President, with the advice and consent of the Senate. There will, however, be a significant reduction in the lower layers of management, including the elimination of the former position of District Director.

The new and modernized IRS is intended to be structured and operated around specific groups of taxpayers with relatively similar needs. The key operational units for the restructured IRS will be 4 new Operating Divisions, each charged with full "end-to-end" responsibility

for serving a designated class of taxpayers with similar needs. The 4 Operating Divisions will be (1) Wage and Investment, (2) Small Business and Self Employed, (3) Large and Mid-Size Business, and (4) Tax Exempt and Government Entities. Each new Operating Division will have full responsibility and authority for serving a defined set of taxpayers, including customer education and assistance and compliance interaction (i.e., audit and collection activities). The proposed new organizational structure for the Service is shown on Appendix A.

The current responsibility for the processing and handling of estate and gift tax returns has been assigned to the new Small Business and Self-Employed Division ("SB/SE"). The SB/SE Operating Division will have a full compliance field organization assigned and associated with it, including both an examination and collection group. The SB/SE Operating Division will be nationally headquartered in New Carrollton, Maryland. It will have 12 area Headquarters Offices (including one in Dallas, Texas) and various field offices throughout the country. The proposed organizational structure for the new SB/SE Operating Division is shown on Appendix B.

Five (5) existing Service Centers will be aligned with the new SB/SE Operating Division; these Service Centers are located in (1) Cincinnati, (2) Ogden, (3) Memphis, (4) Philadelphia, and (5) Brookhaven. The management of the SB/SE Operating Division will have direct authority over the operations of the particular Service Centers assigned to it.

Beginning January, 2001, taxpayers were instructed by the Service to start sending specific tax returns to specific Service Centers designed to focus on specific customer segments. Therefore, the previous Service Center activities which were historically based primarily on a taxpayer's geographic location without regard to the type of return or tax involved, will now be reassigned to a specific Service Center primarily based on the type of return or tax, as well as the taxpayer's geographic location.

The Cincinnati and Ogden Service Centers have initially been designated by the Service to handle the receipt and processing of the business tax returns for the SB/SE Operating Division, which business returns will include both estate and gift tax returns. By the end of the 2002 filing season, it is intended by the Service that all estate and gift tax returns will be filed directly with one of the Service Centers assigned to the SB/SE Operating Division.

The Service is also directed, as soon as practical, to publish the addresses and local telephone numbers of local IRS offices in local telephone directories.

Following the previously announced 1995 reorganization, Texas was aligned with the Midstates Region and was given 3 District Offices - namely the Houston District Office, the North Texas District Office (formerly the Dallas District) and the South Texas District Office (formerly the Austin District). The writer is not presently aware of any changes now pending in regard to these geographic assignments under the new IRS restructuring.

#### D. NEW IRS OVERSIGHT BOARD

The RRA '98 creates a new 9-member Internal Revenue Service Oversight Board ("Oversight Board") to oversee the operations of the IRS. The Oversight Board members will include the Secretary of the Treasury, the IRS Commissioner, a federal employee representative and 6 outside experts. The Oversight Board will recommend to the President candidates for appointment as IRS Commissioner and for the need for removal of an acting Commissioner. The Commissioner is required to consult with the Oversight Board, and the Oversight Board will have review and/or review and approval authority over certain operational plans and management matters. The Commissioner must also submit budget requests to the Oversight Board for review and approval. See Section 1101 of RRA '98 and Section 7802 of the Code.



### E. TAXPAYER ADVOCATE SERVICE

Section 1102 of RRA '98 creates a new position of IRS National Taxpayer Advocate. In 1979 the IRS established the Taxpayer Ombudsman Office, and Congress replaced it by creation of the Office of the Taxpayer Advocate in 1996. Prior to RRA '98, the Taxpayer Advocate was appointed by the IRS Commissioner.

The RRA '98 renames the former Taxpayer Advocate as the "National Taxpayer Advocate" (the "NTA") and changes the structure of the Taxpayer Advocate Service to provide greater independence from the Service. The new NTA will be appointed by the Secretary of the Treasury, after consultation with the IRS Commissioner and the Oversight Board. The NTA will report directly to the IRS Commissioner and will supervise and direct the restructured Taxpayer Advocate Service. The Taxpayer Advocate Service will be a geographically based structure, but is to be independent from the other IRS functions (i.e., Examination, Collection, Taxpayer Service, and Appeals).

RRA '98 also provides for a system of Local Taxpayer Advocates ("LTAs"), whom the NTA will appoint. A least one LTA must be located in each state. The LTAs report to the NTA and not to local IRS management. Presently, the Taxpayer Advocate Service has announced its intentions to station a LTA in the 3 Texas District Offices located in Austin, Dallas and Houston, as well as in each of the 10 existing Service Centers, including the Cincinnati Service Center where all or most estate and gift tax returns will be processed in the future.

The function of the Taxpayer Advocate Service is to assist taxpayers in resolving problems with the IRS. If a taxpayer has an ongoing issue with the IRS that has not been resolved through normal processes, or the taxpayer has suffered, or is about to suffer, a "significant hardship" as a result of the application of the tax laws by the IRS, the Taxpayer Advocate Service may provide assistance, including issuing Taxpayer Assistance Orders in certain cases. The Taxpayer Advocate Service is

not, however, a substitute for established IRS procedures or either the formal or informal Appeals process. The Taxpayer Advocate Service does not have statutory or regulatory authority to reverse legal or technical tax determinations by other Service personnel.

### III. PRACTICE BEFORE THE IRS

#### A. IN GENERAL

Practice before the IRS is regulated by the Director of Practice (the "Director") who is appointed by the Secretary of the Treasury. The Director is responsible for administering and enforcing the regulations governing such practice. The regulations are published by the IRS in pamphlet form as Treasury Department Circular 230. See Treasury Department Circular 230 (Rev. 07-94), "Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, Enrolled Actuaries and Appraisers Before the Internal Revenue Service," Title 31 C.F.R., Subtitle A, Part 10, revised as of July 1, 1994.

#### B. WHAT IS PRACTICE

A person is considered to "practice" before the IRS if he or she (1) communicates with the IRS for a taxpayer regarding such taxpayer's rights, privileges or liabilities under laws or regulations administered by the Service, (2) represents a taxpayer at conferences, hearings or meetings with the IRS, or (3) prepares and files necessary documents with the IRS for the taxpayer. However, the mere preparation of a tax return or furnishing information at the request of the IRS is not considered practice before the IRS. Likewise, merely appearing as a witness for a taxpayer is not considered practice.

#### C. WHO CAN PRACTICE

Generally, attorneys, certified public accountants, enrolled agents and enrolled actuaries (referred to collectively as "Practitioners") can represent taxpayers before the IRS, if they are properly licensed and not currently under suspension or disbarment from practice. Under certain circumstances, other persons, including unenrolled tax return preparers, can also

represent taxpayers before the Service for limited purposes. For example, individuals may represent themselves, a family member can represent members of his or her immediate family, an officer of a corporation, association, organized group or governmental unit can represent the organization of which he or she is an officer, a general partner can represent the partnership, a regular full-time employee can represent the employer, and a fiduciary can represent the entity it serves. Unenrolled return preparers, however, may represent taxpayers only concerning the tax liability for the period covered by the return in question, and may do so only before the Examination function of the IRS, and not before Collection, Appeals or any other function of the IRS. For additional information on the qualifications and enrollment of persons to practice before the IRS, see Sections 10.3 through 10.8 of Treasury Department Circular 230; IRS Publication 947 (Rev. 01-1999), "Practice Before the IRS and Power of Attorney"; and IRS Publication 470 (Rev. 01-82), "Limited Practice Without Enrollment."

#### D. RULES OF PRACTICE

Treasury Department Circular 230, as amended, sets forth and imposes 12 specific duties and restrictions on Practitioners who practice before the Service. See Sections 10.20 through 10.33. In addition, Practitioners cannot engage in "disreputable conduct," which is defined in Section 10.51. Practitioners who neglect or fail to comply with these Rules of Practice or otherwise engage in disreputable conduct are subject to disciplinary action by the Director of Practice and/or suspension or disbarment from practice before the IRS by the Secretary of the Treasury after notice and opportunity for a proceeding. See Sections 10.50 through 10.76.

Practitioners have the following 4 duties under Treasury Department Circular 230 in regard to practice before the Service.

(1) Duty to Furnish Information. Practitioners must promptly submit records or information requested by officers or employees of the IRS, unless they

believe in good faith and on reasonable grounds that the requested information or records are privileged or that the request is of doubtful legality. See Section 10.20.

(2) Duty to Advise. A Practitioner who knows that the taxpayer has not complied with the tax laws or has made an error in or omission from any return or other document required to be filed with the IRS has the duty to advise the client promptly of the non-compliance, error or omission. See Section 10.21.

(3) Duty of Due Diligence. Practitioners must exercise due diligence in preparing, approving and filing tax returns and other papers with the IRS, in determining the accuracy of oral or written representations made by them to the Service, and in determining the accuracy of oral or written representations made by them to clients with reference to any matter administered by the IRS. See Section 10.22.

(4) Duty Regarding Tax Shelters. Practitioners who provide tax shelter opinions analyzing the federal tax effects of a tax shelter investment have a duty to comply with certain requirements regarding their preparation. See Section 10.33.

In addition to the duties noted above, Practitioners are also "restricted" under Treasury Department Circular 230 from engaging in certain conduct or practices.

(1) Delays. Practitioners must not unreasonably delay the prompt disposition of any matter pending before the IRS. See Section 10.23.

(2) Improper Assistance. Practitioners must not knowingly

directly or indirectly (a) employ, (b) accept assistance from, or (c) accept employment as associate, correspondent or subagent from any person who is under disbarment or suspension from practice before the Service. Practitioners are also prohibited from sharing fees with any such persons. Practitioners may not accept assistance from any former government employee where the provisions of Section 10.26 of Treasury Department Circular 230 or any other federal law would be violated. See Section 10.24.

(3) Practice by Former Government Employees, Their Partners and Associates. Practice before the Service is restricted under certain situations for former government employees, their partners and their associates. See Sections 10.25 and 10.26.

(4) Notaries. Practitioners employed as counsel, attorney, or agent in a matter pending before the IRS, or who otherwise have a material interest in such matter, may not engage in any notary activities relative to such matter. See Section 10.27.

(5) Fees. Practitioners may not charge an unconscionable fee for representation of a client before the Service. Practitioners are prohibited from charging a contingent fee for preparing an original tax return, but may charge a contingent fee for preparing an amended return or a claim for refund (other than a claim made on an original return) if the Practitioner reasonably anticipates at the time the fee arrangement is entered into that such amended return or claim will receive substantive review by the Service. See Section 10.28.

(6) Conflicting Interests. Practitioners cannot represent parties with conflicting interests before the Service, except by the

express consent of all directly interested parties (presumably including the IRS) after full disclosure has been made. See Section 10.29.

(7) Solicitations. Practitioners are restricted in regard to their advertising and solicitation of clients with respect to matters pending before the Service. See Section 10.30.

(8) Refund Checks. Practitioners who are income tax return preparers must not endorse or otherwise negotiate any refund check issued to a taxpayer other than the Practitioner.

#### E. STANDARDS FOR ADVISING CLIENTS

Practitioners must follow the so-called “realistic possibility standard” in preparing tax returns or advising taxpayers on positions taken or to be taken on tax returns, unless (1) the position is not frivolous, (2) the position is adequately disclosed on the return and (3) the Practitioner advises the taxpayer of any opportunity to avoid the accuracy-related penalty in Section 6662 of the Code. See Treasury Department Circular 230, (Rev. 07-94), Section 10.34.

#### F. PRIVILEGED COMMUNICATIONS

When a taxpayer seeks legal advice of any kind from an attorney acting in his or her professional capacity, the communications between the attorney and client are “privileged” and are generally protected from disclosure by the client or attorney except where the privilege is waived. Obviously, the primary purpose of the attorney-client privilege is to encourage clients to make full disclosure to their attorneys.

Unfortunately, not all communications between taxpayers and Practitioners are protected. For example, information transmitted to an attorney for the purpose of preparation of a federal tax return may not be privileged. *United States v. Davis*, 636 F.2d 1028 (5<sup>th</sup> Cir. 1981); *United States v. Lawless*, 709 F.2d 485,

487-88 (7<sup>th</sup> Cir. 1983). Furthermore, the disclosure of tax information on a tax return can effectively waive the attorney-client privilege, not only to the transmitted data itself but also possibly to the details underlying that information. *United States v. Windfelder*, 790 F.2d 576 (7<sup>th</sup> Cir. 1986). Prior to RRA '98, communications with accountants or with other non-attorney Practitioners were privileged only if such non-attorney Practitioners had been employed to assist the attorney in rendering legal advice to the taxpayer. See *United States v. Kovel*, 296 F.2d 918, 922 (2d Cir. 1961); *Bernardo v. Commissioner*, 104 T.C. 677 (1995).

Under RRA '98, Congress enacted new Section 7525 of the Code to extend the historical attorney-client privilege to all "federally authorized tax practitioners." However, the new privilege protects only communications involving "tax advice" made on or after July 22, 1998. A "federally authorized tax practitioner" is defined by the Code as any individual who is authorized under federal law to practice before the IRS. Such persons are described in more detail in Treasury Department Circular 230 (Rev. 07-94) and are previously discussed in this paper. Note, however, that the Seventh Circuit has ruled that Section 7525 is inapplicable to communications with attorneys and does not protect work product. *United States v. Frederick*, 182 F.3d 496 (7<sup>th</sup> Cir. 1999). Communications with attorneys remain protected only to the extent of the common law privilege. The term "tax advice" is statutorily defined in Section 7525(a)(3)(B) of the Code, and does not include all communications between the taxpayer and his or her attorney or other federally authorized tax practitioners.

Section 7525 provides that the same common law protections of confidentiality which currently apply only to an attorney-client relationship shall now also apply to communications between a taxpayer and any federally authorized tax practitioner, but only to the extent such communications would be considered a privileged communication between a taxpayer and an attorney. See Section 7525 (a)(1) of the

Code. The legislative history of the statute is clear that information disclosed to an attorney for the purpose of preparing a tax return will not be considered by the Service to be privileged.

As a general rule, it may still be preferable that the taxpayer's attorney(s) retain and communicate with the third party appraisers, business valuers or other third party consultants to "assist" the attorney(s) in providing legal advice to the taxpayer, rather than having those professionals retained directly by the taxpayer. Careful thought and caution should continue to be given to all communications between the taxpayer's attorney(s) and other tax practitioners or between the taxpayer and such other practitioners.

#### G. THIRD PARTY CONTACTS BY IRS

The RRA '98 amended Section 7602 of the Code to require the IRS to now give reasonable advance notice before contacting any third parties with respect to the determination or collection of a tax liability. See new Section 7602(c)(1) of the Code. The Service is further required to periodically provide the taxpayer with a written record of the specific persons contacted by the Service during the period in question. See Section 7602(c)(2) of the Code. The RRA '98 also generally expands the current "third-party recordkeeper" procedures relevant to IRS summons issued to third parties after July 22, 1998, and taxpayers can now bring legal action in the appropriate United States District Court to attempt to quash such IRS summons.

### **IV. POWERS OF ATTORNEY AND TAX INFORMATION AUTHORIZATIONS**

#### A. IN GENERAL

Taxpayers may either represent themselves before the IRS or designate a representative to do so. Generally, the designated person must be a person authorized to practice before the Service as previously discussed. If the taxpayer wants to have the designated person "represent" them before the Service, then either IRS Form 2848, Power of Attorney and Declaration of Representative, or a non-IRS

Power of Attorney acceptable to the Service must be filed. Form 2848 is generally preferable to use for this specific purpose.

#### B. TAX INFORMATION AUTHORIZATION (FORM 8821)

A Power of Attorney form is not required to be filed with the Service if the taxpayer merely wants the IRS to disclose tax information to a designated person or entity, regardless of whether or not the person is authorized to practice before the Service. For this purpose (i.e., disclosure of tax information only), the taxpayer can file IRS Form 8821, Tax Information Authorization, instead. Form 8821 is strictly a disclosure authorization form and cannot be used to designate a person to represent a taxpayer before the Service.

#### C. POWER OF ATTORNEY (FORM 2848)

A Power of Attorney is the taxpayer's written authorization for a designated person to act for and/or represent the taxpayer in tax matters before the IRS. Use of IRS Form 2848 is recommended. If the Power is not limited, generally the designated representative or attorney-in-fact can perform most of the acts that the taxpayer can do. If the taxpayer wants the representative to represent him or her at a conference before the IRS or wants the representative to prepare and file any written response to the IRS, then a Power of Attorney form will be required whether or not the representative performs any of the other acts authorized by Form 2848 or any non-IRS Power. Generally, the taxpayer can only appoint a representative who is a Practitioner authorized to practice before the Service. The taxpayer may use Form 2848 to designate an unenrolled return preparer as a representative only as specifically provided in Publication 470 (Rev. 01-82), "Limited Practice Without Enrollment."

A copy of Form 2848 should be filed with each IRS office with which the Practitioner is dealing. If there are no matters currently pending before the IRS, file the original Form 2848 with the Service Center where the related tax return was, or will be, filed. If the tax return was not previously filed, attach a copy of Form 2848

to the tax return for information purposes. It is recommended that the copy attached to a return be stamped "copy" so that it will not be mistaken by the Service for an original Power and removed from the return.

The IRS currently maintains a Centralized Authorization File ("CAF") in its 10 Service Centers to maintain a file containing information regarding the authority of persons appointed under Forms 2848. The purpose of the CAF is to give Service personnel quicker and greater access to this information. Practitioners who represent clients before the IRS will be assigned an individual CAF number. If you do not have a CAF number at the time a Form 2848 is submitted to the IRS, enter "None" on line 2 of Form 2848 and the IRS will issue you a CAF number.

The IRS will accept a copy of a Form 2848 (and Form 8821 as well) that is submitted by facsimile transmission. Forms 2848 may be faxed directly into the CAF Unit at the Service Center where the related tax return was, or will be, filed. According to the latest information on the IRS's Website ("[www.irs.ustreas.gov](http://www.irs.ustreas.gov)"), the current fax number for the CAF Unit in the Cincinnati Service Center is 859-292-5185.

Form 2848 may be revoked by either sending a "revocation copy" of the original Form 2848 itself to each IRS office where the form was previously filed or the taxpayer may submit a written "revocation statement" to the same IRS offices. Unless the taxpayer has specified otherwise, a subsequently filed Form 2848 for the same tax matter will automatically revoke a previously filed Form 2848, but not a previously filed Form 8821.

Although the IRS will accept qualified non-IRS Powers of Attorney, the information in such document cannot be entered on the CAF. Generally, the writer does not recommend the routine use of non-IRS Powers.

For additional information regarding the preparation and uses of Powers of Attorney or other tax information authorizations, refer to IRS Publication 947

(Rev. 01-1999), "Practice Before the IRS and Power of Attorney"; IRS Publication 216 (Rev. 3-92), "Conference and Practice Requirements"; and Instructions to IRS Form 2848 and Form 8821.

## **V. PREPARATION AND FILING OF RETURNS**

### **A. IN GENERAL**

Preparation for the audit of any tax return LOGICALLY begins with the careful preparation of the return itself. Prior to preparing the return, it is first necessary that all the decedent's pertinent records and documents be carefully scrutinized and that detailed consideration be given to any factual and/or legal issues which might be raised by such items. The initial review of all of the papers, documents and records of the decedent is often done by the personal representative(s) of the decedent's estate without the direct assistance or participation of the Practitioner. Therefore, in preparing both probate inventories and tax returns, it is common that the Practitioner will necessarily be required to rely substantially upon the information and/or documents supplied to the Practitioner by the personal representative(s) or by third parties. It should be noted that in preparing a tax return or in advising a client with respect to a position taken on a tax return, a Practitioner may generally rely in good faith, without independent verification, upon information furnished by the client. However, the Practitioner may not ignore the logical implications of information or documents furnished to, or actually known by, the Practitioner, and must make reasonable inquiries if the information provided appears to be incorrect, inconsistent, or incomplete. See Treasury Department Circular No. 230, §10.34(a)(3) Rev. 07-1994. The Practitioner should always employ the same techniques as those of the Estate Tax Attorney and closely review and consider all of the facts and information provided to him or her for both accuracy and overall consistency with the other facts or documents provided. As a general rule, if an error or omission is discovered after the return is prepared and filed, the return can be "supplemented" or a

claim for refund filed for the estate as discussed later in this paper.

### **B. FILING REQUIREMENTS**

The filing requirements for both federal estate and gift tax returns can most easily be determined by reference to the Instructions to Form 706 or Form 709, respectively. The Practitioner should take care to use the latest revision to such tax forms and instructions. The latest revision to Form 706, United States Estate Tax (and Generation-Skipping Transfer) Return, is July, 1999, and the latest revision to Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return, is 2000. The latest revision to the published Instructions for each tax form corresponds to the date of revision of the form itself. The actual statutory filing requirement for each type of return is set forth as follows.

#### **1. Estate Tax Returns**

The statutory filing requirements for federal estate tax returns are set out in Section 6018 of the Code. The Executor or other personal representative of the estate has the primary duty to file such return. See §6018 (a); Reg. 20.6018-2. However, if the Executor is unable to file a complete return, then the heirs, distributees or third parties in possession or control of any of the property of the decedent may also be required to prepare and file a Form 706 for the estate. See §6018 (b). Currently, a federal estate tax return must be filed for a citizen or resident when the gross value of the estate exceeds the applicable exclusion amount in effect for the calendar year of the decedent's death, subject, however, to certain specified reductions. Therefore, it is the size of the estate and not whether any tax is actually due and payable which is the criteria to determine if Form 706 must be filed. If the gross estate is below but close to the statutory filing requirement, you may still wish to file a return, particularly if the estate consists of any hard-to-value assets such as real estate or closely-held business interests.

#### **2. Gift Tax Returns**

The statutory filing requirements for federal gift tax returns are set out in Section 6019 of the Code. If a federal gift tax return

is required to be filed, it is generally the duty of the donor to file such return. If the donor dies prior to filing the required return, then it becomes the duty of the Executor or other personal representative of the donor's estate to file such return. See §6019; Reg. 25.6019-1.

### 3. Executor Defined

For federal tax purposes the definition of an Executor is much broader than that under local probate law. The term "Executor" means the duly appointed, qualified and acting Executor or other personal representative of the decedent's estate. However, if no Executor or other personal representative is appointed, qualified and acting within the United States, then every person in either actual or constructive possession of any of the decedent's property situated in the United States is "deemed" by federal law to be an "Executor" for federal tax purposes and thereby becomes charged with the statutory duty to prepare and file the requisite federal estate and/or gift tax returns. See §2203; Reg. 20.2203-1; §6018(a); Reg. 20.6018-2. If there are Co-Executors, all are jointly required to file the return. See Reg. 20.6018-2.

## C. TIME TO FILE

### 1. General Rule

Section 6075 of the Code and its corresponding Regulations set forth the original statutory due dates for the filing of both the federal estate tax return and the federal gift tax return. See §6075; Reg. 20.6075-1; Reg. 25.6075-1. The published Instructions to both Form 706 and Form 709 also discuss in detail when each return is required to be filed.

### 2. Timely Mailing

Section 7502 of the Code and its corresponding Regulations set out certain circumstances under which the timely mailing of federal estate or gift tax returns will be treated as the timely filing of such returns. See §7502; Reg. 301.7502-1.

As of July 30, 1996, the IRS was authorized to expand the timely-mailed-is timely-filed rule to designated private

delivery services. Section 7502(f) of the Code. The names of the IRS approved private delivery services which can currently be used by the taxpayer are set forth on page 2 of the Instructions to Form 706.

### 3. Saturday, Sunday or Holiday

Section 7503 of the Code and its corresponding Regulations prescribe procedures for the timely filing of returns when the original due date for filing a return or for paying the tax due falls on a Saturday, Sunday or legal holiday. §7503; Reg. 301.7503-1.

## D. EXTENSIONS OF TIME TO FILE AND/OR TO PAY TAX

### 1. Extensions of Time to File

In cases where it is either impossible or impracticable for the Executor to file a reasonably complete return within the prescribed statutory time limit, the Service may, upon showing of good and sufficient cause, grant a reasonable extension of time to file the subject return. Procedural issues pertaining to obtaining extensions of time to file are discussed in more detail elsewhere in this paper. See §6081(a); Reg. 20.6081-1; Reg. 25.6081-1.

### 2. Extension of Time to Pay

Upon a showing of reasonable cause, the Service may also grant an extension of time to pay all or any part of the taxes required to be shown on the return. Procedural matters pertaining to extensions of time to pay are discussed in more detail elsewhere in this paper. See §6161; Reg. 20.6161-1; Reg. 25.6161-1.

## E. WHERE AND HOW TO FILE

### 1. Where to File

Historically, estate and gift tax returns have generally been filed with the Regional Service Center serving the geographic area where the donor lived and/or the decedent was domiciled at time of death. As part of the restructuring of the IRS, the Service announced on January 5, 2001, that beginning January 1, 2001, all Forms 706 due for decedents domiciled in 21 designated states, including Texas, should now be filed with the Cincinnati

Service Center. All Forms 709 due for tax years 2000 for donors living in the same 21 designated states are also instructed to be filed with the Cincinnati Service Center. Forms 706 and 709 for decedent's and donors domiciled in the remaining states are instructed to continue to be filed according to the Instructions published by the Service for each of those forms. It is anticipated that eventually all estate and gift tax returns will be filed with one of the Service Centers aligned with the new SB/SE Division created pursuant to the RRA '98. It is the writer's understanding that the IRS has chosen the Cincinnati Service Center for this purpose.

The pertinent mailing and physical addresses for filing Forms 706 and Forms 709 for Texas and the 20 other designated states are as follows:

Regular or Certified Mail:  
Internal Revenue Service Center  
Cincinnati, Ohio 45999

Overnight or Express Mail:  
Internal Revenue Service  
Mail Stop 824T  
201 W. River Center Blvd.  
Corrington, KY 41019

## 2. How to File

If the return is filed with the District Office, the return should always be hand carried rather than mailed. All tax returns filed with the District Office are date-stamped with an IRS received date and are then forwarded to the appropriate Service Center for initial processing as hereafter discussed. Filing with the District Office will enable you to obtain a date-stamped copy of the return for your files evidencing the timely filing of the return and of any tax elections or extensions filed therewith. If the return is to be filed directly with a Service Center as directed by the Instructions, the document must be mailed since the Service Centers are restricted access facilities and historically have not accept hand carried documents or payments. The Service Center has procedures to accept and acknowledge receipt of tax returns sent by either registered or certified mail, if verification of a

specific received date by the Service is required or desirable. The writer recommends that all returns and most other documents mailed to the Service always be sent by registered or certified mail, return receipt requested.

## F. COMPLETENESS OF RETURN

### 1. In General

The tax return should be as complete as possible in all respects, and all required questions should be answered on the return. Failure to properly complete the return and thoroughly explain the entries therein can increase the return's chances of being at least "tentatively" selected for audit.

### 2. Documents and Information Required with Return

The Regulations and the Instructions to both Form 706 and Form 709 set out various documents and information that are required to be attached to or filed with the returns. These include such documents as certified copies of Wills, trust documents, Form 712, various tax elections and various other documents required to substantiate the entries made on the returns. Reg. 20.6018-3; Reg. 20.6018-4; Reg. 25.6019-3; Reg. 25.6019-4; Instructions to both Form 706 and Form 709.

### 3. Omitted Items or Entries

Failure to attach the required documentation or to fully address the factual or legal issues raised by specific entries on the return may "red flag" the return to during the classification of the return. At the time of the initial classification of the return, the classifier is routinely reviewing a large number of returns to select only those returns which show the highest audit potential. A thorough and complete return, with all factual and legal issues identified and adequately discussed, will generally have a better chance of being "accepted as filed" rather than being selected for an audit. If the estate has previously been granted an extension of time to file the return and/or to pay the tax thereon, but Form 4768 is not attached to the return, delinquency penalties may be assessed upon processing of the return. If required tax elections are not attached to the return, then



substantial tax benefits might be lost to the estate.

#### 4. Incomplete Entries on Returns

Both federal estate and gift tax returns are initially processed at a Service Center where they are reviewed for statutory form and proper execution and then math verified for accuracy. Failure to make complete and accurate entries on the appropriate lines of the returns or a failure to properly complete one or more required schedules of the return to support an entry made may result in a delay in the processing and acceptance of the return or even a recompilation by the Service Center of the tax reported on the return, with a resulting tax notice being sent to your client. For example, a marital deduction claimed and entered on line 20 of the "Recapitulation" schedule may be reduced to "0" on the initial processing of the federal estate tax return if there is no supporting "Schedule M" attached to Form 706 which reflects the amount of property passing to the surviving spouse corresponding to that entry.

### G. MISCELLANEOUS MATTERS

#### 1. Decedent's Gift Tax Returns

In addition to preparing and filing any unfiled federal gift tax returns which may be required to be filed for the decedent, the personal representative of the estate also needs to accurately determine the previous gift history of the decedent, if any, in order to determine the correct amount of the decedent's "adjusted taxable gifts" for federal estate tax purposes. The Executor may request copies of all of the decedent's previously filed federal gift tax returns, if any, from the Service under provisions of Section 6103(e)(3) of the Code. Under certain conditions set forth in Section 2204(d) of the Code, a good faith reliance by the personal representative of an estate on the documents furnished to it by the Service may serve to discharge the Executor from any personal liability for any federal estate tax deficiency which might be attributable to an increase in the "adjusted taxable gifts" which may finally be required to be reflected on decedent's Form 706.

#### 2. Credit for Tax on Prior Transfers

It is also advisable to obtain copies of all prior estate tax returns, audit reports, Estate Tax Closing Letters, inheritance tax returns, and any other information or documents required to substantiate a claimed credit for tax on prior transfers to the Service. If necessary, copies of the needed tax returns to substantiate the credit can be requested by the personal representative from the Service under authority of Section 6103(e)(1)(E) of the Code.

#### 3. Notice of Fiduciary Relationship

Every person acting for another person in a fiduciary capacity is required to give notice thereof to the Service in writing. Form 56, Notice Concerning Fiduciary Relationship, is used for this purpose. The Form should be filed with the Service Center where Form 706 has, or will be, filed and should be transmitted separately from the federal estate tax return. Proper filing of Form 56 will insure that all tax notices from the Service concerning the decedent's income, estate or gift tax returns are directed to the personal representative. See §6903; Reg. 301.6903-1. A subsequently filed Form 56 can also be used to inform the service of the termination of a fiduciary relationship.

### VI. PROCESSING OF ORIGINAL AND AMENDED RETURNS

#### A. IRS SERVICE CENTERS

The initial processing of both Form 706 and Form 709 will be handled at one of the Service Centers aligned with the new SB/SE Operating Division. The writer understands that the Service currently intends to have all estate and gift tax returns processed at the Cincinnati and/or Ogden Service Centers.

#### B. CONTROL NUMBER

Both estate and gift tax returns are processed using the decedent's social security number. It is imperative that the correct social security number be used. If the decedent did not have a social security number at the time of the death, the Executor is instructed to file Form SS-5 with

the Social Security Administration to obtain a social security number for the decedent. See Instructions to Forms 706 and 709.

### C. PROCESSING OF RETURNS AT SERVICE CENTERS

#### 1. Receipt of Returns

Upon receipt of a tax return at the Service Center, the return is "date-stamped" and any payment accompanying the return is detached for crediting to the proper taxpayer account. Historically, the federal estate tax returns were grouped according to the specific District Office with jurisdiction over the geographic area in which the decedent resided at the time of death. Presumably, a similar procedure will be used under the restructuring of IRS. Prior to final processing, the return will be assigned a digit document locator number (the so-called "DLN") for Internal Revenue Service control purposes. A portion of this DLN reflects the Gregorian calendar date on which the tax return was filed, and this number may be used to establish timely filing of the returns and any elections thereon or therewith. If the return is received by registered or certified mail, a record of such receipt is kept at the Service Center, and a return receipt to the taxpayer will be acknowledged if requested.

#### 2. Verification of Returns

Before computer processing of the return takes place, it is first reviewed by Service Center personnel to insure that the return is properly executed and that the appropriate schedules and required documents are attached to the returns. In addition, each schedule is manually verified for any mathematical or clerical errors (i.e., obvious entries on the wrong line of the return) and such errors are corrected during processing. If any correction made to the return at the Service Center results in a change to the tax reported on the return as filed, the taxpayer will receive a computer-generated tax notice informing the taxpayer of the error and of the amount of any additional tax due or overpayment resulting from the correction of the mathematical or clerical error made on the return.

#### 3. Elections, Extensions and Penalties

During the initial processing of the return at the Service Center, other matters requiring "special handling" are identified (i.e., Section 6166 elections, Section 2204 requests, payments of tax by flower bonds, etc.), and the returns are coded to reflect such matters. The assessment or waiver of any delinquency penalties on the return is also initially considered at this time and all statements or affidavits regarding "reasonable cause" for such delinquency are reviewed at the Service Center prior to assessment of the penalties. Applications for extensions of time to pay the tax, requests for releases of liens or any other items requiring additional action are separated from the return itself and routed to the appropriate Service Center or District Office function for further administrative processing.

#### 4. Association with Gift Tax Returns

After processing, all federal estate tax returns are associated with any Forms 709 which the decedent may have previously filed.

### D. ASSESSMENT OF TAX ON ORIGINAL RETURN

The Service has been given statutory authority to assess all taxes voluntarily determined or reported on federal tax returns filed by the taxpayer. This statutory authority also extends to the assessment of any interest or penalty due on such disclosed tax. See §6201(a)(1); Reg. 301.6201-1.

### E. DEFICIENCY DEFINED

The term "deficiency" for federal estate or gift tax purposes means the amount by which the correct federal estate or gift taxes as finally imposed or determined exceeds the excess of the sum of the tax shown by the taxpayer on the original return plus any amounts previously assessed as a deficiency over the amount of any tax abatements. See §6211(a); Reg. 301.6211-1.

## F. ASSESSMENT OF A DEFICIENCY

### 1. Statutory Notice Required

Except for certain special limited exceptions (i.e., jeopardy assessments, bankruptcy and receivership cases, etc.), a statutory “deficiency” may not be assessed by the government until a formal Notice of Deficiency (the so-called “90-Day Letter”) has been sent to the taxpayer by registered or certified mail, and such 90-day period has expired (150 days if the Notice of Deficiency is addressed to a person outside the United States). See §6212 and §6213.

### 2. Petition to Tax Court

Upon receipt of a statutory Notice of Deficiency, the taxpayer has 90 days (or 150 days as the case may be) to file a petition in the U.S. Tax Court requesting a predetermination of the purported deficiency. If such petition is timely filed, then no assessment of the proposed deficiency can be made by the government, and no levy or other court proceedings for its collection may be made by the Service until the decision of the Tax Court has become final. See §6213; Reg. 301.6213-1.

## G. MATHEMATICAL AND CLERICAL ERRORS ON RETURNS

### 1. Corrected at Service Center

As previously discussed, all mathematical or clerical errors appearing or disclosed on the original return are “corrected” by the Service Center during the initial processing of the return.

### 2. Not a Deficiency

The amount of any understatement of tax resulting from such mathematical or clerical errors does not constitute a “deficiency” under Section 6211 of the Code and may be assessed by the Service Center without issuance of a formal Notice of Deficiency. In addition, the computer-generated notice received by the taxpayer from the Service Center informing him of a mathematical or clerical error on the return and the resulting adjustment to the tax reflected on the return is not a Notice of Deficiency; and, therefore, the taxpayer may not file a petition in Tax Court to prevent

either its assessment or enforced collection by the Service. See §6213(b)(1).

### 3. Abatement on Demand

Within sixty (60) days after notice of an assessment resulting from a mathematical or clerical error is sent, the taxpayer may request an abatement (i.e., removal) of such assessment and the Service Center is required to abate the tax. Thereafter, any reassessment of the tax must be made through normal deficiency assessment procedures, which means that the return will be selected for audit or examination. See §6213(b)(2)(A).

## H. SUPPLEMENTAL RETURNS

### 1. Omitted or Newly Discovered Assets

After the filing of the original estate or gift tax return, the personal representative, donor or practitioner may discover additional assets of the estate gifts or identify other errors or omissions on the return as filed which are sufficient enough to warrant the revision or correction of the original return previously filed. If such errors or omissions will result in a reduction (i.e., overpayment) of the tax previously reported, assessed, and paid, such corrections are properly reportable on Form 843, Claim for Refund. Claims for Refund are discussed in more detail elsewhere in this paper. If such corrections, however, would result in an increase to the gross estate or gross gifts of the decedent or donor, then such additions are typically reported on a so-called “amended return.”

### 2. No Amended Estate Tax Returns

Except as permitted under Reg. 20.2032A-8(d) and Reg. 20.6166-1(h), the federal estate tax return may not technically be “amended” after the expiration of the due date for filing the original return (including any period of extensions). See Reg. 20.6081-1(c). The Regulations, however, do specifically provide that “supplemental information” may be subsequently filed with the Service which may result in a finally determined tax different from that reported on the original estate tax return. It is not too surprising, therefore, that such supplemental information is generally

presented to the Service in the Form of an “amended” Form 706. If a supplemental return or information is filed which reflects a decrease in tax previously reported, it will be treated as an informal claim.

### 3. Assessment of Additional Tax

Unless the statute of limitations for assessment has expired, any amount of additional taxes shown on the supplemental or amended return is treated under Section 6201(a)(1) as amounts voluntarily shown by the taxpayer “upon his return,” and such amounts are routinely assessed by the Service without going through formal deficiency assessment procedures. However, if the applicable statute of limitations for assessment under Section 6501 of the Code has expired, the Service cannot make an additional assessment of tax unless such assessment is voluntarily requested by the taxpayer, and then only to the extent that additional taxes and/or interest are voluntarily paid by the taxpayer with such request. Voluntary payments of tax that are assessed and paid after the expiration of the period of limitation on assessment may be refunded to a taxpayer if a claim for refund is timely filed within the 2-year period after payment of such amount. See Rev. Rul. 74-580, 1974-2 C.B. 400;

### 4. Issues to Consider

Frequently in estate administrations an omitted asset may surface after the return has been accepted or even audited by the Service and the normal statute or limitations for assessment (i.e., the 3-year statute) has already expired. If the value of the omitted asset is not significant, the Practitioner might consider merely forwarding an information letter to the Service Center where the return was filed disclosing the omitted asset or assets as a part of the decedent’s gross estate, but without requesting a “voluntary” assessment of any additional taxes and without making any “voluntary” payment of tax with such notification. In making such notification to the Service, the Practitioner should consider the application of Section 6501(e)(2) of the Code (dealing with substantial omissions of items from the gross estate or from the total amount of gifts of a donor). The mere

disclosure of an omitted asset to the Service, without a request for a voluntary assessment and payment of the resulting tax, generally means that the estate will not be issued a “revised” Estate Tax Closing Letter. Because the statutory discharge of any estate tax liens on the newly discovered asset is frequently the primary or sole reason for reporting the omitted asset in the first place, the personal representative may have no real option but to request a voluntary assessment of the additional tax and to make payment of such tax and interest with his request.

## **VII. CLASSIFICATION OF RETURNS**

### A. GENERAL

Historically, federal tax returns have been classified at both Service Centers and at District Offices. For federal income tax returns, the Service uses a computer classification program known as the “Discriminant Function System” (DiF) as its primary method of selecting returns for audit. Estate and gift tax returns, however, have historically been manually reviewed and classified by Estate Tax Attorneys in local District Offices, the writer has been advised that this procedure will be changing under the new IRS restructuring.

### B. ESTATE TAX RETURNS

After the initial processing of a federal estate tax return is completed by the Service Center, the Form 706 and its associated file were previously forwarded to the various District Offices for classification. See Estate and Gift Tax Handbook § 1.2.1. These returns are generally classified by the Group Manager or other senior Estate Tax Attorneys in the District audit groups. Some District Offices also have an Estate Tax Coordinator position and paraprofessional support personnel. During this manual classification process, each return was individually reviewed, and those returns reflecting either obvious errors or otherwise considered to have the highest audit potential were selected for examination. The remaining returns were “accepted as filed,” and those returns were returned back to the Service Center for final administrative closing. Forms 706 were to be classified by

the District Office within 30 days of the receipt of the return. Previously, a computer-generated Estate Tax Closing Letter was also produced when the return was processed at the Service Center and this document is mailed to the taxpayer from the District Office. In general, it could take up to 6 months before the Estate Tax Closing Letter was received. During the classification of the returns, the classifier is required to reviewed and consider any elections under Section 2032A, Section 2057, and Section 6166 made by the Executor with the return. The writer is advised that the Service is in the process of implementing a new "centralized" classification system for the initial classification of Forms 706 at the Service Center rather than in the local District Offices. The processing Service Center(s) will have estate Tax Attorneys on staff or detailed to the Service Center(s) to periodically classify and review the documents thee. The writer anticipates that certain returns (i.e. large closely held business interests, estates with Section 2032A or Section 2057 elections, etc.) will probably continue to be sent to the District Offices for manual review by local Estate Tax Attorneys, but the majority of the returns filed will be classified by the Service Center. If the return is identified as having audit potential, it will be sent to the District Office for final determination by the local examination groups. Returns accepted as filed will have the newly designed "estate Tax Closing Letter" issues by the Service Center. This procedure should slightly speed up the issuance of Closing Letters on most returns.

#### C. GIFT TAX RETURNS

As previously noted, Forms 709 were previously filed alphabetically in the applicable Service Center by District Office reference, and such returns are generally classified by Estate Tax Attorneys detailed into the Service Center for that purpose. See Estate and Gift Tax Handbook § 1.2.2. Gift tax returns selected for audit in this manner are forwarded to the appropriate District Estate Tax Group for examination. Most examinations of Forms 709 have historically been a direct result of the audit of decedent's estate tax return, but

Practitioners are reporting increased audits of Forms 709, particularly those reflecting the transfer of "discounted" business interests.

#### D. SELECTED RETURNS

Returns that are selected for examination by the classifier are sent to the appropriate Estate Tax Group to be assigned to an Estate Tax Attorney in the Group for audit. In some District Offices, some of the returns selected may be suspended by the Group in a so-called "Ready File" until the workload within the Group permits the Group Manager to assign the selected case to an individual Estate Tax Attorney for audit. Although tentatively selected for audit, prior to the time that the Executor or Practitioner is actually contacted by the Estate Tax Attorney, the return may still be "surveyed" or accepted without examination by either the Group manager or the assigned Estate Tax Attorney. If surveyed, the return is returned to the Service Center for final administrative processing.

### VIII. AUDIT OR EXAMINATION OF RETURNS

#### A. WHO IS THE EXAMINER

Since 1968, graduation from an accredited law school and bar membership have been prerequisites to employment in the Estate Tax Groups, and most examiners hold a commission as an "Estate Tax Attorney." In addition to a legal background, the Estate Tax Attorney will also have gone through specialized training courses in estate and gift tax laws and probably will have received some additional classroom instruction in the valuation of various types of assets, including real estate and closely held business interests. Some Groups also have attorneys who previously worked for District Counsel's Office.

#### B. INITIAL CONTACT

Some audits will be instituted by the Estate Tax Attorney by letter advising the Executor and Practitioner of the selection of the return for examination. The preferred manner of initiating an audit, however, is by telephone. Generally, the Estate Tax

Attorney will inform the Practitioner of any additional information or documents which he or she will want to see or obtain during the course of his examination. If the valuation of real property is to be a major issue in the audit, the Estate Tax Attorney will frequently want to schedule an appointment to physically inspect the property in question. Examinations of returns selected for audit are to be initiated within 9 months of the date of filing of the return. Estate and Gift Tax Handbook § 1.5.

### C. AUTHORITY OF PRACTITIONER

#### 1. Declaration on Return

Page 2 of Form 706 contains a Declaration to be signed by the Practitioner authorizing the Service to release or discuss confidential tax information with the person listed, and also authorizing the named Practitioner to represent the taxpayer before the Service unless otherwise expressly extended. The instructions to Form 706 provide that by completing this Authorization on page 2 of the return one attorney, accountant or enrolled agent may receive such confidential tax information. The writer is advised by the Estate Tax Attorney in the Cincinnati Service Center, that a copy of the Estate tax Closing Letter will also be sent to the designated Practitioner. However, if the Practitioner has not already obtained either a Form 2848, Power of Attorney, or Form 8821, Tax Information Authorization, signed by the Executor, the Estate Tax Attorney will frequently request that the Practitioner provide such form at or prior to the initial audit conference.

#### 2. Form 2848

Form 2848, Power of Attorney, is used to grant more comprehensive authority to the Practitioner representing the estate before the Service. Form 8821 only authorizes the Practitioner to receive and inspect confidential tax information. If necessary or desirable, the power to execute tax returns and/or to redelegate authority to a substitute representative might be specifically added to Form 2848. The practitioner should remember that, as with other non-durable Powers of Attorney, the Practitioner authority to act will be

terminated by the death or incapacity of the principal (i.e., the Executor or donor).

### 3. Representative Identification Numbers

The Service has established a Centralized Authorization File (CAF) at the service Centers to identify Practitioners who practice before the Service and the scope of their authority. The stated purpose and benefits of this CAF system are to permit the Service's computers to automatically generate copies for the practitioner of all tax notices and computer-generated correspondence. The practitioner should enter his assigned CAF number on all Forms 2848 or Forms 8821 filed with the Service.

### D. SCOPE OF AUDIT

The Estate Tax Attorney is instructed to pursue only significant issues in an audit and to review all unusual language, large or questionable items reflected on the return. Estate and Gift Tax Handbook § 1.6.1. Although the Service instructs its Estate Tax Attorneys to specifically limit the focus or scope of their audits to substantial and material tax issues, the initial contact from the Estate Tax Attorney will generally request additional information or documentation regarding a large number of items or entries made on the return. The review of many of such issues is routine and can be easily disposed of at the initial conference.

### E. TIME LIMITATION ON AUDIT

It is the stated policy of the Service to conclude its examination of the federal estate tax return within 18 months after the filing of the return. See IRM 1.2.1.4.16, P-4-52 (Approved 02-02-1959) In most cases, the examination (including any additional conferences with the Appeals Office in unagreed cases) can be completed within this stated time frame. Although the Estate Tax Attorney is not strictly limited to a specific period of time in which to complete the audit (other than that set by the applicable statute of limitation on assessment of the tax), there are, in fact, substantial "time restrictions" or pressures on the Estate Tax Attorney to conclude the audit in the shortest time possible. The

Practitioner should be aware, therefore, that dilatory practices in providing requested information or in the scheduling of conferences with the Estate Tax Attorney may simply result in the cases being brought to the attention of the Group Manager with perhaps added pressures on the Estate Tax Attorney to simply close the audit on less favorable terms to the taxpayer or on a totally unagreed basis.

#### F. TRANSFERS TO OTHER DISTRICTS

The transfer of the examination of a return to another District Office may be requested by the taxpayer or might be done at the election of the Service. Generally, an examination will be transferred to another District only if it can be more effectively and efficiently disposed of by primary examination in such other District. For example, the Executor and most of the estate's records or property may be located in another state or jurisdiction and an examination of the return by the District Office where the Executor resides and where the property is located may be preferred by both the taxpayer and the Service.

#### G. COLLATERAL INVESTIGATIONS

If information regarding property or records located in another District is required to complete an audit, the Estate Tax Attorney may request that a collateral investigation be conducted by the Estate Tax Group in that District, and a written report of such investigation will be furnished to the Estate Tax Attorney. This procedure is frequently followed when the estate owns valuable real estate or mineral interests situated in other states or Districts.

#### H. SECTION 2204 ELECTIONS

If the personal representative has filed an application for discharge of personal liability under Section 2204 of the Code, the Estate Tax Attorney is instructed to give priority to the examination of the return in order to determine the amount of any deficiency due by the estate within the 9-month period provided for by the statute. In reality, however, an election under Section 2204 generally neither increases the chances of an audit nor necessarily

guarantees a more expeditious examination of the return if it is selected.

#### I. INCOME TAX RETURNS

During the course of the audit, the Estate Tax Attorney is required to review the decedent's final Form 1040, the Form 1040 for a full year preceding the date of death, and all Forms 1041 filed for the estate and any trusts. In preparing the estate tax return, the Practitioner should obtain copies of these returns for his or her file and review the returns for any apparent audit issues. The Estate Tax Attorney will inspect these returns to look for omitted assets such as interest on certificates of deposit or other savings, dividends paid on unreported stocks, unreported livestock, or crops deductions claimed on real estate or other assets, etc. In addition to estate tax issues, if the Estate Tax Attorney believes that the income tax returns provided to him reflect income tax issues of sufficient compliance value to warrant a separate audit of those returns by a Revenue Agent, the Estate Tax Attorney will prepare a so-called "information report" which sets out the nature of the potential audit issues. These information reports are subsequently reviewed and classified by Revenue Agents and those showing the highest audit potential may be assigned for field audit of the appropriate income tax return or returns.

#### J. CONDUCT OF AUDIT AND CONFERENCES

##### 1. In General

The careful preparation of the return and organization of the file prior to examination of the return can greatly simplify the audit by having most, if not all, of the requested information on hand and available for the Estate Tax Attorney to review. In addition, the prior consideration (and perhaps legal research) of those issues which the Practitioner believes are most likely to be raised by the Estate Tax Attorney on audit can greatly assist the Practitioner in staying in control of the audit. The single most important rule to remember during the conduct of the audit is "LET THE ESTATE TAX ATTORNEY TAKE THE INITIATIVE IN THE CONDUCT OF THE AUDIT." Often those valuation matters or

legal issues which the Practitioner is most concerned about frequently are not raised or only minimally reviewed by the Estate Tax Attorney during the audit.

## 2. Attendance of Executor at Conferences

The question of whether or not the Executor attends all or any of the audit conferences is basically a decision to be made by the Executor and the Practitioner. Occasionally, the Estate Tax Attorney will specifically request that the Executor be present, but such requests are the exception rather than the rule. Most Practitioners prefer to meet alone with the Estate Tax Attorney, at least prior to the time that the Estate Tax Attorney is ready to present his final "proposed" adjustments for consideration. A few Practitioners, however, like to fill their office or conference room with the Executor, family members, accountant, appraisers, etc. It is the personal preference of this writer to meet alone with the Estate Tax Attorney since I believe such conferences are much less formal and are more conducive to a frank exchange of information and opinions.

## 3. Discussion of Issues

The Estate Tax Examiner's Handbook recommends to the Estate Tax Attorney that he or she always begin audit conferences with discussion of any routine matters before moving to the more controversial items. Frankly, this procedure is a good one for both the Practitioner and the Estate Tax Attorney to follow, and many of the less significant issues can be satisfactorily disposed of in this manner. Section 7521 allows either the taxpayer or the Service to audio record (not video) the "in person" interviews upon 10 days notice to the other side.

## 4. Major Audit Issues

The Technique Handbook for Estate Tax Attorneys discusses most of the major audit issues which will routinely arise during the examination of estate and gift tax returns. The Technique Handbook offers helpful insights into the procedures and techniques which the Estate Tax Attorney has been trained to employ in auditing those items. Since the majority of audit issues

probably involve the valuation of assets included in the estate, the Service's "IRS Valuation Training for Appeals Officers Coursebook" can also be extremely helpful to the Practitioner in determining what methods and approaches the Estate Tax Attorney might employ in the conduct of his examination. Items which tend to be particularly good about attracting an audit are:

- (1) a "yes" answer to any of the disclosure questions on the return;
- (2) indication that assets have been sold or that sales are pending;
- (3) litigation, particularly will contests, noted on the return;
- (4) life insurance trust;
- (5) inter vivos trust (looking for gifts from trust within 3 years of date of death);
- (6) substantial gifts prior to death, particularly if made by an attorney-in-fact;
- (7) disclosure of assets, the value of which are omitted from the gross estate;
- (8) unanswered questions on Sch. G. of the return;
- (9) large tracts of real property;
- (10) large mineral properties;
- (11) family limited partnership or other closely held business; and
- (12) ANY MENTION OF THE WORD "DISCOUNT."

## 5. Authority of Examiner

Although the Estate Tax Attorney is responsible for the audit of the return and for the development of the facts and law applicable to the issues in controversy, the Practitioner should always remember that, unlike the Appeals Officer, the Estate Tax Attorney has not been delegated settlement authority by the Service and is not authorized to settle the case on the basis of "hazards of litigation." The Estate Tax



Attorney, therefore, is required to “negotiate” with the taxpayer on the basis only of the law and facts applicable to the case. However, the lines between “settlement” and “negotiation” often get blurred, and, therefore, some basis for compromise with the Estate Tax Attorney can generally be found.

#### 6. Closing the Audit

At the conclusion of the audit, the Estate Tax Attorney will make his or her audit adjustment proposals to the Executor and/or to the Practitioner. Depending on the acceptance or non-acceptance of such proposals by the Executor, the Estate Tax Attorney will close the audit of the return in one of the following ways: (1) no change, (2) agreed or partially agreed, or (3) unagreed. Each of these audit actions are discussed more fully below.

#### K. “NO-CHANGE” CASES

Frankly, most returns selected for audit are going to produce some change in tax to the estate or donor. It may be either a deficiency or a refund, but some tax change usually results. Indeed, the criteria for selection of the return for audit initially was that the return contained at least one audit issue likely to result in a tax change. On occasion, however, the Estate Tax Attorney will agree that there are simply no adjustments to be made to the return, and the examination will be closed. In such cases, the Executor will be advised that the return is being accepted as filed, and no official audit report will be sent to the Executor by the Estate Tax Attorney. Since the primary purpose of the classification process is to select those returns with the highest audit potential, it is not too surprising that the Estate Tax Attorney will generally show great reluctance to simply “no change” a case. Therefore, an agreement on one or more of the minor audit issues resulting in either a small increase in tax or a small refund of tax is often preferable to the Estate Tax Attorney.

#### L. AGREED CASES

##### 1. Waiver

If the Executor or donor wishes to conclude the examination on an “agreed

basis” and accepts the final tax and valuation adjustments proposed by the Estate Tax Attorney, the Executor or donor will be requested to execute Form 890, Waiver of Restrictions on Assessment and Collection of Deficiency and Acceptance of Assessment-Estate and Gift Tax (the “Waiver”). This Waiver reflects the agreement of the Executor or donor to the assessment of the tax deficiency and/or penalty adjustments reflected on the Waiver. It further authorizes the Service to assess such amounts without the issuance of the formal statutory notice of deficiency otherwise required by Section 6212 of the Code.

##### 2. Payments and Interest Assessments

Upon receipt of a signed Form 890, the Estate Tax Attorney will date and initial the Waiver to evidence its “official” date of receipt. The Practitioner should advise the client that the amounts reflected on the face of Form 890 do not include the statutory interest which will be assessed in addition to the tax and penalty shown on the Waiver. If the taxpayer wishes to stop the accrual of additional interest on the agreed tax deficiency, an advance payment of the amount of the tax deficiency should be submitted to the Estate Tax Attorney along with Form 890. Indeed, the Estate Tax Attorney is instructed to solicit an advance payment of the tax deficiency. This advance payment will be credited to the taxpayer’s account, and interest on the tax deficiency paid will be assessed by the Service only up to the date of receipt of such payment. Interest, however, will also be due on the interest assessed but unpaid, and the client should be advised accordingly. If the taxpayer wants to pay all amounts due with Form 890 (i.e., tax, penalty and accrued interest), the Estate Tax Attorney should be able to calculate that amount. If payment of the tax deficiency is not submitted with Form 890, then upon assessment of the deficiency, the Service will also assess statutory interest on the deficiency up until 30 days after the received date reflected on the Waiver or until the actual date that payment of the tax deficiency is received, if earlier. Interest on the tax deficiency and upon the accrued

interest on such deficiency will also be assessed. The taxpayer will subsequently receive a Notice of such assessment from the Service Center and will have 10 days from the date of such notice to make payment thereof before interest begins to run again.

### 3. Audit Report and Closing Letter

Following the receipt of the Waiver, the Estate Tax Attorney prepares an official examination report (the so-called "RAR"). Most Estate Tax Attorneys have direct access computers and such reports are now routinely computer-generated. After preparation of this RAR, the administrative file is returned to the Service Center for final administrative actions as needed.

### M. POST-AUDIT REVIEW

Although an agreement with the Estate Tax Attorney may have been obtained, the Practitioner should be aware that the Estate Tax Attorney's report and agreement are subject to an administrative quality control process within the Service. The case files and reports may be reviewed by both the Group Manager and/or by separate reviewers. This review process consists of a verification of the mathematical computations made on the Examination Report as well as a technical review of the issues examined by the Estate Tax Attorney. If major errors are found by the Group Manager or the Review Staff, the case is returned to the Estate Tax Attorney for further action or response by the attorney. It is possible, therefore, that an assumed "agreement" with the Estate Tax Attorney may not, in fact, be accepted by either his Group Manager or the Review Staff and the administrative file will be returned to the Estate Tax Attorney for further audit or correction of the Examination Report.

### N. PARTIAL AGREEMENTS

It is not necessary that the Executor agree with all of the Estate Tax Attorney's proposed adjustments in order to close part of the audit on a agreed basis. The Executor may execute a Form 890, Waiver, only with respect to those adjustments which the Executor is in agreement with the Estate Tax Attorney and not agree to any

other audit proposals made by the Estate Tax Attorney. In such cases, the Estate Tax Attorney will prepare two reports – (1) an agreed report covering only those issues agreed upon and (2) an unagreed report dealing with all remaining audit issues that were not agreed upon. The Executor may also wish to pay the agreed portion of the "proposed" tax deficiency while continuing to maintain the estate's right to contest those valuation or legal issues covered by the unagreed report. A partial agreement with a payment of the agreed portion of the proposed tax deficiency can reduce the overall interest cost to the estate or donor. Some Practitioners believe that an "all-or-nothing" tactic will somehow influence or pressure the Estate Tax Attorney into making concessions on the more controversial matters or believe that they should retain even agreed upon issues until the appeal of the case is heard in order to "horse-trade" with the Appeals Officer. It is the personal opinion of this writer that, unless the issues in question are material and are themselves the subject of dispute, they really have very little influence on either the Estate Tax Attorney or Appeals Officer; therefore, it is recommended that, as a general rule, all audit issues should be resolved at the earliest possible date.

### O. UNAGREED CASES

If the Estate Tax Attorney's proposed adjustments are not acceptable to the Executor or donor, the examination of the return will be concluded by the attorney on an "unagreed" basis. In preparing the unagreed report, the Estate Tax Attorney will often make as many adjustments to the return as possible, some of which may not have even been specifically discussed during the examination of the return. For example, it is not uncommon for the Estate Tax Attorney to deny on the report a deduction for any debt, administration expense or charitable bequest which either remains unpaid at the conclusion of the audit or which was not otherwise substantiated by the Executor at that time. The credit for state death taxes claimed on Form 706 may be "tentatively" disallowed pending filing of proof of payment of such amounts by the Executor. The Service has now taken the position with respect to state

death taxes that an underpayment of federal estate tax will occur any time the state death tax is extended past the normal due date for payment of federal estate tax, and the state death tax credit claimed on the return exceeds the taxes actually paid to the state at that time. See TAM 8947005.

The denial of unpaid or estimated attorney fees and commissions is another favorite adjustment of the Estate Tax Attorney on unagreed reports. Although most, if not all, of these items can be easily substantiated and corrected upon appeal of the Estate Tax Attorney's findings, it can often be confusing to the client, and somewhat embarrassing to the Practitioner, to explain how the Estate Tax Attorney's "proposed 50,000 tax deficiency" has suddenly become the \$90,000 or \$100,000 deficiency reflected on the Estate Tax Attorney's official audit report. Therefore, if an agreement cannot be reached with the Estate Tax Attorney, the Practitioner should determine from the Estate Tax Attorney what specific adjustments to the return he or she intends to make on the RAR and provide the Estate Tax Attorney with satisfactory documentation that the debts, commissions, attorneys fees and/or state death taxes claimed on the return have either been paid or satisfactorily provided for. At this point the unagreed tax deficiency cannot be assessed by the Service, and the estate or donor will be entitled to an administrative appeal within the Service prior to the issuance of the required statutory Notice of Deficiency.

## **IX. APPEALS**

### **A. IN GENERAL**

After the Estate Tax Attorney prepares his unagreed report on the audit of the return, the administrative case file will be reviewed by the Group Manager and/or the Review Staff and the case will be processed as an unagreed case.

### **B. 30-DAY LETTER**

The District Office will send the Executor a copy of the Estate Tax Attorney's official examination report advising the Executor that he will have a 30-

day period in which to file a written protest (the "Protest") to the proposed adjustments and tax deficiency reflected in such audit report. The audit report is accompanied by IRS Publication 5 (Rev. 01-1999) which sets out the specific requirements and procedures for preparing and filing a written Protest and for requesting a conference with an Appeals Officer in the Office Of Appeals. Form 890, Waiver, is also enclosed with the 30-Day Letter in the event the Executor has changed his or her mind and now wishes to agree to the assessment of the proposed deficiency.

### **C. PREPARATION OF PROTESTS**

In preparing Protests the Practitioner should be comprehensive and cite and discuss the facts, law and authorities on which he or she relies. This written Protest is probably the very best opportunity to convince the Appeals Officer of the merits of the taxpayer's position. Its function is similar to that of an appellate brief, and should be prepared with as much thoroughness. Because the 30-Day Letters are issued from the Estate Tax Group, the Protests are initially received and reviewed by an Estate Tax Attorney who compares the issues and arguments set forth in the Protest and the position of the taxpayer thereon with the issues and positions previously taken during the audit of the return itself. This pre-Appeals review allows the Estate Tax Attorney to specifically review and respond to the taxpayer's arguments and authorities in his private administrative report.

### **D. EXTENSIONS TO FILE PROTESTS**

Although there is not statutory requirement to do so, generally the Service will grant a reasonable extension of time in which to prepare and file the written Protest if such request is made timely and for good cause. Extensions are usually granted in additional 30-day segments, and all such requests for extensions should be directed to the attention of the specific person or office reflected on the 30-Day Letter issued to the taxpayer.

### **E. ISSUANCE OF 90-DAY LETTER**

If the written Protest is not timely filed, or an extension timely requested and

obtained, the Service will issue its formal Notice of Deficiency (i.e., the so-called “90-Day Letter”) advising the taxpayer that the proposed tax deficiency will be assessed unless a petition is timely filed by the taxpayer in the United States Tax Court within a 90-day period. After the 90-day period has expired, the Service may assess and collect the tax deficiency if the petition in the tax court was not timely filed by the taxpayer.

#### F. OFFICE OF APPEALS

If the taxpayer timely files a written Protest and requests an appeal, then the administrative case file and the taxpayer’s Protest are forwarded to the Appeals Office for scheduling of an administrative hearing or appeal. The proposed new organizational structure for the Appeals Office is shown on Appendix C. The Appeals Office, however, will not accept a case within 4 months of the expiration of the statute of limitations. Upon receipt of the case in the Office of Appeals, it will be assigned to an Appeals Officer for hearing. At such hearing the taxpayer may be represented by the practitioner. If the taxpayer is not present at such conference, the Practitioner will be required to file Form 2848, Power of Attorney, if the Practitioner has not previously done so with the Service. Such hearings or conferences are generally informal and generally only the Practitioner and the Appeals Officer are present. Testimony is not usually under oath, but most written information or documents are usually required to be submitted under declaration of penalty of perjury. Either side may make an audio recording (not video) of the conference upon 10 days written notice to the other side.

#### G. APPEALS OFFICER

The Appeals Officer holds a full-time position within the Appeals Office . Many Appeals Officers who hear disputed estate and gift tax cases were previously Estate Tax Attorneys themselves. Some Appeals Officers, however, may be former Revenue Agents, and therefore, may not have any legal training or significant practical experience in either estate and trust administration or in estate or gift tax matters. Depending upon the nature and

complexity of the issues involved (and, of course, on the strengths or weaknesses of your case), you may wish to specifically request in your Protest or cover-letter transmitting same that the case be assigned to an Appeals Officer with prior estate tax training and experience.

#### H. SETTLEMENT AUTHORITY

Unlike the Estate Tax Attorney, the Appeals Officer has previously been delegated settlement authority for the Service and can consider the “hazards of litigation” in the resolution of the issues in the case as well as resolving any issues on the basis of law and fact. The Appeals Office has sole settlement authority for the Service over all cases which are not actually docketed for trial with the Tax Court, except for fraud cases. After a 90-Day Letter is issued and prior to the time that the case is actually docketed for trial by the Tax Court, both the Appeals Office and attorneys from the District Counsel’s Office will jointly participate in further settlement negotiations. Some practitioners prefer this joint settlement procedure in the belief that it puts added “pressure” on the Service to settle the case. My personal opinion is that it also puts added pressure on the taxpayer and the Practitioner, and I generally prefer to have the issues more thoughtfully considered at the Appeals Office. If an agreement cannot be obtained from the Appeals Office, once the 90-Day Letter has been issued and the petition in Tax Court filed, the Practitioner may thereafter bring District Counsel’s Office into the negotiations at that time.

#### I. CONCLUDING THE APPEAL

##### 1. Agreed Cases

If an agreement can be reached with the Appeals Officer, the Executor or donor will be requested to execute either Form 890, Waiver, or Form 890-AD, Waiver. Use of Form 890, Waiver, is generally recommended because Form 890-AD contains language that purports to have the taxpayer consent to waive the right to file a claim for refund or otherwise subsequently challenge the positions agreed to with the Appeals Officer. The Appeals Officer will prepare an official report which reflects the

agreement of the parties and sets forth the tax adjustments resulting therefrom. If the Executor or donor wishes to do so, payment of the agreed tax deficiency, if any, can be made to the Appeals Office along with the filing of the Waiver.

## 2. Unagreed Cases

If settlement of the case cannot be reached with the Appeals Officer, an unagreed report is prepared and a formal Notice of Deficiency is issued to the Executor or donor. The taxpayer will have a 90-day period following the date of mailing of this statutory Notice in which to file a petition in Tax Court. After a petition is filed with the Tax Court, the Appeals Office and District Counsel's Office will continue to try to negotiate a settlement of the case with the taxpayer up to the start of the session in which the case is set for trial. Thereafter, District Counsel's Office will have sole jurisdiction over the handling, trial and settlement of the case.

## **X. MISCELLANEOUS MATTERS AND PROCEDURES**

### A. GIFT TAX DISCLOSURES

Prior law permitted the Service to revalue any gift at the time of its review of an estate tax return. For gifts made after August 5, 1997 and properly disclosed on a gift tax return, the values of such gifts will be fixed for all estate and gift tax purposes upon the expiration of the period for assessment under Section 6501, barring any contest of that value by the IRS. See Sections 2001(f) and 2504(c). In order to start the 3-year period of assessment, the gift must be disclosed in a manner adequate to apprise the Service of the nature of the transfer. See Section 6501(c)(9). The Regulations under Section 6501(c)(9) require that the return provide:

- (1) a description of the transferred property and any consideration received by the donor;
- (2) the identity of, and relationship between, the donor and the donees;
- (3) if the transfer was in trust, then the trust's TIN and a brief description of

the trust's terms (or a copy of the instrument);

- (4) a detailed description of the method used to value the transferred property, including detailed financial information used to determine the value, any restrictions on the transferred property that were considered, and a description of any discounts; and
- (5) a statement describing any position taken contrary to any proposed, temporary or final regulation or Revenue Ruling published at the time of the transfer.

The regulations also require substantial information on interests in various types of business entities. See Reg. 301.6501(c)-1(f)(2)(iv). To avoid providing that detailed financial information, the donor may attach to the return a copy of an appraisal prepared by a qualified appraiser. See Reg. 301.6501(c)-1(f)(3) for the required character of the appraiser and the appraisal. If a gift is not disclosed in the preceding manner, then the period for assessment will not begun to run.

The regulations also provide for the deemed disclosure, without the filing of a gift tax return, of any transaction occurring in the ordinary course of business and between family members, as long as the transaction is properly reported by all parties for income tax purposes. Another interesting aspect is that the period for assessment will run for incomplete gifts reported as completed gifts, but will not run for complete gifts reported as incomplete gifts. Finally, see Revenue Procedure 2000-34 for disclosure of gifts not originally reported on the return filed for the year of gift.

### B. CLAIMS FOR REFUND

#### 1. In General

In the case of any "overpayment" of tax by the estate or donor, the Secretary is authorized to first credit the amount of such overpayment against any other outstanding tax liability owed by the same taxpayer and to refund the balance of such overpayment, if any, to the estate or donor. See §6402(a).

Wherever it is determined by the taxpayer that the estate or gift tax has been overpaid, the Executor or donor may file a claim for refund of such overpayment.

## 2. Considerations Before Filing

The mere fact that federal estate or gift tax may have been overpaid does not necessarily mean that the Executor or donor should automatically file a claim for refund. It should be understood and discussed with the client that the filing of a claim for refund once the estate tax return has been accepted and the Estate Tax Closing Letter issued will constitute a request by the Executor for a "voluntary reopening" of the case, and such action may result in a previously accepted return, as well as the claim itself, being audited by the Service. In view of this fact, it is the common practice of some Practitioners to wait to file such claims just immediately prior to the date that the statute of limitations for assessment by the Service under Section 6501 of the Code expires. Although the Service may still raise all audit issues to "offset" any claimed refund, the Service cannot assess an actual tax deficiency against the taxpayer in excess of the claimed overpayment. Caution must be exercised to insure that both the statute of limitations for filing the claim has not expired and that the statute of limitation for assessment by the Service has expired.

## 3. Form:

A claim for refund of overpayment of federal estate or gift tax should be made on Form 843, Claim for Refund, and should be executed by the Executor or donor. The latest revision of Form 843 is January, 1997. The claim may either be mailed to the Regional Service Center or hand-carried to the local District Office. Claims for refund should always be prepared in great detail since any later suit by the estate or donor on the alleged overpayment of taxes may be limited to those specific grounds stated and the matters and issues raised in the claim. The Practitioner will generally include in the claim any actual or "estimated" administration expenses (i.e., attorney fees) incurred in connection with the preparation of the claim. Alternate theories of recovery, even though

inconsistent with one another, should be set forth in detail in the claim.

## 4. Statute of Limitations on Filing

Claims for refunds of estate or gift taxes must be filed either within 3 years from the time the tax return was filed or within 2 years from the time the tax was actually paid, whichever period is later. See §6511(a). If the return was filed early and/or the tax paid prior to the original due date for paying such tax, then the return and/or payment of the tax will be deemed to have been made on the original due date for purposes of determining the application of both the 3-year and the 2-year limitation periods. See §6513(a).

## 5. Limitations on Amount Refunded

If a claim is filed under the 3-year limitation rule, then the amount to be refunded is limited to the tax paid within that period of time immediately preceding the filing of the claim equal to 3 years plus the period of any extension of time to file the return which had been previously granted. If the claim is filed under the 2-year rule, then the refund is limited only to those taxes actually paid during the 2-year period immediately preceding the filing of the claim for refund. See §6511(b)(2).

## 6. Initial Processing of Claims

If a claim is filed before the original tax return has been accepted and/or examined by the Estate Tax Group in the District Office, the claim will be associated with the original tax return, and the claim's issues will be considered by classifier or by the Estate Tax Attorney along with other issues on the return. However, if the original return has previously been accepted and closed by the Service, the claim will be initially reviewed by the Estate Tax Attorney(s) stationed in the Service Center. Most claims do not involve controversial issues and can often be accepted as filed at the Service Center without any examination of the claim's issues by the District Office Estate Tax Group. After the tax assessed against an estate is corrected, the Service Center will issue a "revised" Estate Tax Closing Letter to the Executor evidencing the revised amount of federal estate taxes assessed against the estate. If the Service

Center believes that the claim is inaccurate or if the claim relates to an issue previously examined by the District Office Estate Tax Group upon audit of the return to which the claim relates, the claim is generally selected for audit and forwarded to the appropriate District Office Estate Tax Group for its further consideration. Generally, such claims are promptly assigned by the Group Manager to an Estate Tax Attorney for audit. If the return to which the claim relates was audited by an Estate Tax Attorney in the Group, the claim is generally also assigned to that attorney.

#### 7. Claims Selected for Audit

Upon receipt in the District Office Estate Tax Group, the claim is reviewed for audit potential. Many claims will simply be “surveyed” or accepted without further examination and returned to the Service Center for abatement of the tax. If the claim is assigned to an Estate Tax Attorney for audit, the examination of the claim is required to be initiated by the estate Tax Attorney within a maximum of 30 work days following receipt of the claim in the Group. The Estate Tax Attorney is also required to give priority to the examination of the claim in order to minimize the amount of interest which the government must pay to the taxpayer upon any refund of the tax. Upon audit of the claim, the claim will be either accepted in full or rejected by the Estate Tax Attorney, in whole or in part. If the claim is rejected in whole or in part and the taxpayer wishes to agree with the Estate Tax Attorney’s determination, the Executor or donor will be requested to sign Form 2297, Waiver of Statutory Notification of Claim Disallowance, and the Estate Tax Attorney will prepare an examination report reflecting the adjustments, if any, agreed upon by the Executor and/or donor. The filing of this Form 2297 will commence the 2-year statutory period in which the taxpayer must commence suit to recover that part of the claim which was disallowed by the Service. If the Executor or donor does not agree with the Estate Tax Attorney’s determination on the claim issues, then the examination of the claim will be entitled to an administrative appeal with the Appeals Office upon the timely filing of a written Protest.

#### 8. Request for Immediate Claim Disallowance

In general, a taxpayer may not commence suit to seek to recover the claimed overpayment of tax prior to the expiration of 6 months from the date that a claim for refund is filed with the Service unless the Service renders its decision on the claim prior to such date. If the claim for refund is based solely or primarily on disputed estate or gift tax issues which were previously considered upon audit of the applicable tax return, the taxpayer may choose to expedite the denial of the claim in order to promptly proceed with litigation on the disputed issues. Therefore, if the taxpayer does not want to pursue a further appeal of those issues within the Service, the Executor or donor may request in writing that the claim be immediately rejected and disallowed. Upon receipt of such requests, the Service will promptly issue its Form 2297, Statutory Notice of Claim Disallowance, and the taxpayer will have 2 years in which to file a refund suit in either the United States District Court or the United States Court of Claims.

#### 9. Protective Claims

If the statute of limitations for filing a claim is about to expire, the Executor or donor may file a “protective” claim with the Service, pending final resolution of the litigation or other matter which precludes the immediate consideration of the claim. Upon receipt of protective such claims, they are to be “suspended” by the Service until such time as the taxpayer requests the active consideration of the claim. In preparing such claims, Form 843 should clearly be marked “Protective” to prevent its immediate consideration and possible issuance of a Statutory Notice of Claim Disallowance.

### C. CLOSING LETTERS

#### 1. Service Center Function

The Service Center(s) aligned with the new SB/SE Operating Division and assigned to process estate and gift tax returns will be responsible for the issuance of the Estate Tax Closing Letters.

## 2. Legal Effect

The Estate Tax Closing Letter is not a formal Closing Agreement issued under the authority of Section 7121 of the Code. *Est. of Ella Meyer*, 58 T.C. 69 (1972); *Schwager v. Comm.*, 64 T.C. 781 (1975). However, the examination of a previously accepted or audited estate tax return will be reopened by the Service to make an adjustment unfavorable to the taxpayer only under very limited, appropriate circumstances. The procedures for reopening of “closed” estates are contained in Revenue Procedure 94-68, a copy of which is enclosed with the Estate Tax Closing Letter itself. That Revenue Procedure is reproduced in Appendix D to this paper.

## 3. Voluntary Requests to Re-Open

The filing of a claim for refund or an amended or supplemental return by the Executor constitutes a request for a “voluntary” reopening of the estate, and it is not necessary for the Service to go through the formal procedures set forth in Rev. Proc 94-68 to reopen the review or examination of the federal estate tax return.

## D. DISCHARGE OF PERSONAL LIABILITY

### 1. Section 2204

#### a. In General

Section 2204 and its corresponding Regulations provide that the Executor may make written application to the Service for a determination of the federal estate taxes due by the estate and for a discharge of personal liability therefrom. Within 9 months after the filing of such request for discharge, the Executor is to be notified by the Service of the amount of the federal estate tax and, upon payment of such amount, the Executor will be discharged from any personal liability for any deficiency in tax thereafter found to be due by the estate.

#### b. Form

A request under Section 2204 of the Code must be in writing, should specifically refer to Section 2204 or otherwise expressly state that it is a request for discharge of

personal liability for federal estate taxes, and should be attached to Form 706 if made at the time the original return is filed. §2204; Reg. 20.2204-1. Requests for so-called “prompt audit or review” of the return or for “early action” will not be considered or treated by the Service as Section 2204 requests. A request for discharge may also be made by the Practitioner on behalf of the Executor if the Practitioner has filed a properly executed Form 2848 with the Service.

### c. Effect on Statute of Limitations

Section 2204 is a “notice” provision, and a discharge of the Executor under its provisions does not effect the Service’s statute of limitations for actual assessment of a tax deficiency under Section 6501 of the Code. Section 2204 pertains only to the discharge of the Executor’s personal liability for payment of tax, and its application does not prevent or void a subsequent assessment of a tax deficiency against the estate. In addition, the Executor continues to be fully liable for such deficiency in his fiduciary capacity to the extent of the remaining estate assets in the Executor’s possession or control. *Est. of Ella Meyer*, 58 T.C. 69 (1972); *Est. of Bert L. Sivyver*, 64 T.C. 581 (1975); Reg. 20.2204-1(a).

### d. Other Fiduciaries

A fiduciary other than the Executor (i.e., a Trustee of an *inter vivos* or testamentary trust) may also make written application for discharge of personal liability under Section 2204. If such an application is made by a non-Executor, the fiduciary will be discharged either 6 months after the discharge is requested by the fiduciary or upon the discharge of the Executor under Section 2204(a), whichever event is later. §2204(b); Reg. 20.2204-2. In view of the above, unless the Executor requests a discharge under Section 2204, the other fiduciaries are precluded from obtaining their own discharge from personal liability.

### e. Certificate of Discharge

Form 7990, U.S. Estate Tax Certificate Of Discharge from Personal Liability, is a formal certificate of discharge which will be issued to the Executor upon specific written request for same. Such



requests should (i) be in writing, (ii) specifically request Form 7990, and (iii) should provide the decedent's name, social security number, date of death and the latest document locator number for the tax return shown on the Estate Tax Closing Letter. Such requests should be mailed to the Service Center where the return was processed. Form 7990-A, U.S. Gift Tax Certificate of Discharge from Personal Liability, is available for gift tax purposes. It should be noted that the current Estate Tax Closing Letter incorporates in it the discharge language under Section 2204 of the Code and will also to discharge the Executor from personal liability if an application was made for same on the estate tax return when it was originally filed.

#### 2. Section 6905

The Executor may also request a discharge from personal liability for the decedent's unpaid income and gift taxes. Form 5495, Request for Discharge From Personal Liability Under Internal Revenue Code 6905, should be used for this purpose. This Section is also a "notice" provision and acts only to discharge the Executor from personal liability. It does not shorten the applicable statute of limitations for assessments nor does it preclude the subsequent assessment of an income or gift tax deficiency.

#### 3. Section 6501(d)

The Executor may, in addition to merely requesting a discharge from personal liability for the decedent's income and/or gift taxes, actually request the prompt assessment of such taxes under provisions of Section 6501(d) of the Code. This provision is not a "notice" provision, but actually serves to reduce or shorten the statute of limitations applicable to the assessment of those taxes. The request should be made on Form 4810, Request for Prompt Assessment Under Internal Revenue Code Section 6501(d), and must be mailed by separate envelope to the appropriate Service Center after the subject tax return has been filed. These requests are promptly associated with the applicable tax returns and are reviewed for audit or acceptance as filed. If accepted, a letter is sent to the Executor advising of the

acceptance of the subject returns. If the classification of the return indicates high audit potential, the return is selected for audit and sent to the appropriate District Office for examination. Although many requests are made by Executors under Section 6501(d) of the Code for the prompt assessment of federal estate taxes, the practitioner should be aware that the statute is made expressly inapplicable to the federal estate tax. See §6501(d).

#### 4. Installment Payment of Tax

Even if the federal estate tax is being paid in installments under Sections 6166, 6163 or 6161, the Executor may, nevertheless, obtain a discharge from personal liability for such taxes by either posting a bond for such amount or by electing the special tax lien under Section 6324A provided for such purpose. See §2204(a); §2204(c).

### E. EXTENSIONS OF TIME TO FILE AND PAY

#### 1. Service Center Function

Extension requests will be processed and acted on by the Service Center assigned to process the estate or gift tax return in question.

#### 2. Form and Content

Applications for extensions of time to file Form 706 and/or to pay the federal estate tax due thereon are made on Form 4768. This form has a separate section for the Executor to request either or both an extension of time to file Form 706 or an extension of time to pay all or any part of the estate tax due thereon, under provisions of Section 6161 of the Code. Both portions or sections of the form should be completed, since an extension of time to file the return will not act to extend the time for payment of the tax and visa versa. See Reg. 20.6081-1(c); Reg. 20.6161-1(c)(3). There is no comparable Service form for gift tax returns, and the request for an extension of time to file a Form 709 and/or to pay the federal gift taxes due thereon, if any, should be made in writing, in letter form addressed to the Service Center. A practitioner who signs the declaration on the front of Form 4768 can file the request for the estate

without having to submit a Form 2848, Power of Attorney, with the application. The reasons given for any requested extensions should be detailed and fully developed in order to insure that the requests are not summarily denied by the Service Center.

### 3. Processing the Applications

All application for extensions should be filed with the Service Center, and should be filed in adequate time to permit the Service Center to consider and act on the request before the original due date for filing the return or for paying the tax expired. The Service Center will return one or more copies of Form 4768 to the taxpayer evidencing its action on the application.

### 4. Late Applications

Although it is rarely done by the Service, an extension of time to file the return may, under very special circumstances, be granted even though the application requesting the extension was not timely filed. See Reg. 20.6081-1(b). Such requests are sometimes made by the Executor in an attempt to qualify the estate for a "lost" tax benefit or election required to have been made on a timely filed return. Except as expressly provided, a delinquent application for an extension of time to pay the tax will not be considered by the Service under any circumstances. See Reg. 20.6161-2(c).

### 5. Maximum Period of Extension

Unless the Executor is abroad, an extension of time to file the return cannot be granted for more than a maximum of 6 months from the original due date of the return. See Reg. 20.6081; Reg. 25.6081. Currently, approved extensions are automatically granted for the maximum 6 month period, even if a shorter period of extension was requested. An extension of time to pay all or any part of the original estate tax due with the return may not exceed a maximum period of 10 years. See §6161(a)(2). Such extensions are to pay generally granted in 12 month periods, and are subject to an annual review by the Collection function of the Service. An extension of time to pay a part of an estate tax deficiency may also be granted by the Service, but such extension may not exceed

a maximum period of 4 years from the initial date fixed for payment of such deficiency. See § 6161(b)(2).

### 6. Payments With Extensions

In general, an extension of time to pay will be granted only for the amount of the claimed "cash shortage." On occasion, the Service may require, or the Executor may elect, to pay a portion of the estimated estate taxes due at the time Form 4768 is filed. If the amount paid with the extension request represents a good faith estimate of the final tax liability reported on the return, the Service has ruled that any excess payment will be treated as an "overpayment" of tax, and the estate will be entitled to receive interest on the refund of such excess. See Rev. Rul. 81-189, 1981-2 C.B. 240.

### 7. Denied Extensions

The granting of an extension of time to file the return is totally within the discretion of the Service, and there is no express statutory or regulatory right of appeal in the event the request is denied. *Crissey v. U.S.*, 80-1 USTC ¶13,335 (D.C. N.Y. 1980); See §6081. However, if an extension of time to pay the estate tax under Section 6161 is denied by the Service, the Executor may file a written appeal within 10 days from the date such denial is mailed to the Executor. See Reg. 20.6161-1(b); Instructions to Form 4768. The authority to hear such appeals has been previously delegated to the Appeals Office. If the denied extension application requested both an extension of time to file the return and an extension of time to pay the tax, the Appeals Officer will "administratively" reconsider both requests even though the right of appeal technically applies only to the denied extension of time to pay the tax. The decision of the Appeals Officer is final, and there is no further appeal on the issue.

## F. SECTION 6166 ELECTIONS

### 1. Form of the Election

An election under Section 6166 of the Code to pay a portion of the estate tax in installments must be made on or before the date set for filing the return (including

extensions thereof). The election must be in writing and contain the information required by the Regulations. The election should be attached to the timely filed estate tax return. See §6166; Reg. 20.6166-1(b).

## 2. Initial Processing

During the initial processing of the return at the Service Center, the return is identified as an installment case, and a “tentative” installment account or installment notice file is set up at the Service Center for the estate.

## 3. Final Determination

Historically, the District Office Estate Tax Group has been responsible for determining whether an election made by the Executor meets the qualifications of Section 6166. Elections are accepted or selected for additional review during the classification process for the returns. If accepted, the appropriate function in the Service Center will be notified to that effect. If the election and/or the return itself are selected for examination, the Estate Tax Attorney will make his final determination regarding such election during the course of the audit, and the Executor will be advised accordingly. If the election is tentatively denied by the Estate Tax Attorney, the Executor will be given an opportunity to appeal the Estate Tax Attorney’s determination before the decision is final.

## 4. Appeal of Denied Elections

If the Estate Tax Attorney believes that the election does not meet the qualifications of Section 6166, the Executor is entitled to a hearing with the Appeals Office before the decision is final. See Rev. Proc. 79-55, 1979-2 C.B. 539. The decision of the Appeals Officer is final, and there is no further administrative appeal on the issue.

## 5. Redeterminations on Audited Cases or Claims

The installment payments may be recomputed because of the determinations of tax deficiencies, overpayments and/or changes to the ratio of the qualified closely-held business interest. The Service has issued examples and procedures which illustrate the recomputation of the

installment amount under such situations. See Rev. Rul. 81-294, 1981-2 C.B. 237.

## G. SPECIAL ESTATE AND GIFT TAX LIENS

### 1. In General

The Code provides for special estate and gift tax liens which arise instantly at the date of death or date of gift and which have a duration of 10 years from such dates, unless the estate or gift taxes due by the estate or donor are paid in full or otherwise become unenforceable by reason of lapse of time. These liens attach to all property comprising a part of the decedent’s gross estate and to all gifts made during the period for which the gift tax return was filed. These liens are in addition to the general tax lien provided for by Section 6321. See §6324(a)(1) and §6324(b); Reg. 301.6324-1.

### 2. Authority to Discharge Liens

Local District Offices have historically been responsible for processing requests submitted to them by an Executor or donor for discharge of any or all property subject to the special estate and/or gift tax lien imposed on such property by Section 6324. See Estate and Gift Tax Handbook § 5.4; Reg. 301.6325-1(c). If the Service determines that the estate or gift tax due has been satisfied or otherwise provided for, the Service is authorized to issue a certificate of discharge on any or all of the property subject to the lien. See §6325(c); Reg. 301.6325-1(c)(1).

### 3. Procedures to Obtain Releases of Lien

Form 4422, Application for Certificate Discharging Property Subject to Estate Tax Lien, should be filed directly with the Estate Tax Group in the District Office responsible for collection of the tax. There is, however, no specific IRS Form for requesting a discharge of the gift tax lien, and such requests should be made in letter form in the manner set out in Reg. 301.6325-1(c)(2). If the subject property is being sold, a copy of the executed sales contract should be attached to the Application. The issuance of a certificate of discharge is discretionary with the Service

and will only occur if there is an actual need for such certificate. See Estate and Gift Tax Handbook § 5.4. The Service will generally not issue a certificate of discharge after the Estate Tax Closing Letter has been issued and the taxes paid, nor will a release be given merely to effectuate a distribution or division of the property among the decedent's heirs or distributees free of the estate tax lien. A release of lien can be obtained regardless of whether or not Form 706 has been filed at the time Form 4422 is submitted. See Estate and Gift Tax Handbook § 5.4. If the return is not yet filed, the applicant is instructed to use "estimated" amounts to the extent they can be determined. See Form 4422.

#### 4. Certificates of Discharge

If the Estate Tax Group Manager determines that a release or discharge of the lien is appropriate, Form 792, United States Certificate Discharging Property Subject to Estate Tax Lien, is issued to the Executor. A copy of such certificate is associated with and retained in the estate tax file. The Service has generally been agreeable to expediting the review of release of lien requests upon a showing of good cause for same.

#### 5. Escrow of Funds

If the estate tax is unpaid and the request for discharge of lien applies to all or the majority of the real property included in the decedent's gross estate, then it is common practice for the Service to require all or a specific portion of the net proceeds of sale to be placed into an escrow account pending issuance of the Estate Tax Closing Letter and the payment of the tax. Form SWRE-224, Escrow Agreement, may be used by the Executor to establish an acceptable escrow account prior to the issuance of the certificate of discharge. This "suggested" agreement will permit the use of the escrowed funds to pay the federal estate taxes due by the estate.

#### 6. Subordination of Lien

Frequently the real property subject to the lien is not being sold, but is simply being used as security or collateral to secure a loan. Requests for subordination of the estate tax lien should also be made

on Form 4422 and filed with the Estate Tax Group in the District Office. If it appears that the subordination of the federal tax lien will not detrimentally affect the collection of the unpaid estate taxes, and the remaining property is adequate to secure the payment of such taxes, the Service will generally issue Form 792 to the Executor evidencing such subordination. See §6325(d); Reg. 301.6325-1(d).

### H. PENALTIES

#### 1. In General

Section 6651 of the Code provides for the assessment of certain civil penalties for failure to either timely file a return or to timely pay the taxes due. The assertion of a penalty by the Service may initially arise at the time of the processing of the tax return at the Service Center or may be raised as an audit issue by the Estate Tax Attorney during the course of his examination. Few issues tend to anger or frustrate both the taxpayer and the practitioner alike as do questions concerning the assessment of penalty.

#### 2. Initial Consideration at Service Center

The Service Center has the initial responsibility for determining whether or not "reasonable cause" exists for the late filing of the return and/or the payment of the tax. If the return is filed late and an extension of time to file the return has not previously been obtained, the Executor should attach a detailed statement to the return setting forth his or her reasons why the return could not be timely filed and the tax timely paid. Such statements are considered by the Service Center prior to the assessment of the penalties, and it is generally much easier to prevent the assertion of the penalty than to have the penalty abated after it has already been assessed. If the Service Center processing the tax return believes that the statement reflects reasonable cause for the delinquency, then the return is coded to prevent the assessment of penalty. However, if there is no such statement attached to the return or the circumstances set forth in the statement are considered insufficient to constitute "reasonable cause" for the delinquency, then penalties will be

assessed upon processing of the return, and a computer-generated Notice will be issued to the Executor or donor advising him of such penalty assessment. Unfortunately, it has been the experience of this writer that the affidavits or statements of the taxpayer are overlooked on the processing of the return and the reasonable cause of the taxpayer is not considered on the merits before the penalties are assessed.

### 3. Review by Estate Tax Attorney

If a determination on the penalty issue has previously been made by the Service Center prior to the audit of the return by the Estate Tax Attorney, the Estate Tax Attorney is advised that he should generally not disturb that determination except under very limited circumstances. For example, the request for abatement of the penalty may be initially raised by the taxpayer during the examination of the return, or the Estate Tax Attorney may determine that the taxpayer misrepresented the facts in his statement on which the penalty was abated by the Service Center.

### I. VERIFICATION OF TAX PAYMENTS

Although the Estate Tax Closing Letter may be used as evidence of the filing and acceptance of the Federal estate tax return, it does not verify the payment of the estate tax reflected thereon. Proof of payment can be provided by copies of cancelled checks or by any receipt for the estate tax which may have been requested by the Executor under Section 6314(b) at the time such payment was made to the Service. In order to have available a full and detailed summary of all assessments and payments made on the estate's account, the Executor may request that the Service Center issue Form 4340, Certificate of Assessment and Payments, to the estate.

## XI. HOT AUDIT ISSUES

Perhaps the best way to determine the current "hot audit issues" of the IRS at any given time is to simply review the current tax reporters and literature to determine what issues the Service is litigating and issuing

rulings on. Some of the issues which appear to this writer to be on the Service's radar screen are set out below. For an IRS perspective on some of these issues refer to James L. Gulley's recent Article and presentation given at the State Bar's Advanced Estate Planning and Probate Law Course in 1997. See Gulley, "IRS Hot Topics", 21<sup>st</sup> Annual Advanced Estate Planning and Probate Law Course, Dallas, Texas, June 4-6, 1997.

### A. FAMILY LIMITED PARTNERSHIP

The family limited partnership ("FLP") continues to be THE number one audit matter for the Service. Although the Service to date has not had a great deal of success with its litigation involving FLPs, the IRS is definitely not conceding much to the taxpayers at this time. A list of the FLP cases to date is attached to this paper as Appendix G.

### B. ABUSIVE TRUST

Perhaps the next big audit focus will be on so-called "Abusive Trusts". The Service is increasingly concerned about the perceived misuses of both foreign and domestic trusts, and the IRS has recently undertaken a national coordinated strategy to address what it considers to be fraudulent trust schemes. For more information on the Service's perspective on this matter, refer to IRS Publication 2193 (Rev. 11-1999).

As a consequence of this new audit focus, it is the opinion of this writer that trusts, particularly foreign and other types of inter vivos trusts will get increasing scrutiny from the Service.

### C. ADMINISTRATIVE EXPENSES

The deductibility of administration expenses, particularly those interrelated the marital or charitable deductions continue to get regular IRS attention. It is the experience of this writer that the proposed adjustment of claimed administration expenses is one of the Estate Tax Attorney's most treasured tools in avoiding the dreaded "no change" audit case.

### D. GIFTS BY ATTORNEYS-IN FACT

The IRS continues to challenge gifts made by attorneys-in-fact under power of

attorney forms that do not contain a specific authorization for the attorney-in-fact to make such transfers.

#### E. CLAIMS AT DEATH

Recently there have been several cases dealing with the deductibility of unliquidated claims owed by the decedent at death, particularly litigation claims. For a flavor of this dispute see *Smith v. Commissioner*, 198 F.3d 515 (5<sup>th</sup> Cir. 1999) and *McMorris v. Commissioner*, 2001-1 USTC ¶60,396 (10<sup>th</sup> Cir. 2001).

#### F. UNLIQUIDATED INTEREST DISCOUNTS

The IRS continues to challenge discounts claimed for undivided interest in real property and/or to limit the amount of discount claimed to the "cost of partition." Frankly, the Service has not been very successful in its efforts.

#### G. DISCOUNTS

If a discount is claimed on an estate or gift tax return for anything, the chances of an audit of the return are significantly increased.

**APPENDIX E**  
**FORMS RELEVANT TO TRANSFER TAX RETURNS**

<b><u>Form</u></b>	<b><u>Description</u></b>	<b><u>Revised</u></b>
SS-5	Application for a Social Security Card	Feb. 1998
56	Notice Concerning Fiduciary Relationship	Aug. 1997
668-H	Notice of Federal Estate Tax Lien Under Internal Revenue Laws and Certificate of Release of Federal Estate Tax Lien	July 1987
668-J	Notice of Federal Estate Tax Lien Under Internal Revenue Laws and Certificate of Release of Federal Estate Tax Lien	August 1980
669-F	Certificate of Subordination of Federal Estate Tax Lien	June 1981
706	United States Estate (and Generation-Skipping Transfer) Tax Return	July 1999
709	United States Gift (and Generation-Skipping Transfer) Tax Return	2000
712	Life Insurance Statement	May 2000
792	United States Certificate Discharging Property Subject to Estate Tax Lien	Nov. 1980
843	Claim for Refund and Request for Abatement	Jan. 1997
890	Waiver of Restrictions on Assessment and Collection of Deficiency and Acceptance of Overassessment – Estate, Gift, and Generation-Skipping Transfer Tax	Oct. 1988
890-AD	Estate Tax – Offer of Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and of Acceptance of Overassessment	Nov. 1980
977	Consent to Extend the Time to Assess Liability at Law or in Equity for Income, Gift, and Estate Tax Against a Transferee or Fiduciary	Feb. 1987
1273	Report of Estate Tax Examination Changes	Dec. 1980
2297	Waiver of Statutory Notification of Claim Disallowance	March 1982
2848	Power of Attorney and Declaration of Representative	Dec. 1997
3259	U.S. Certificate Discharging Property Subject to Gift Tax Lien	Dec. 1982

4351	Interest Computation-Estate Tax Deficiency on Installment Basis	April 1989
4421	Declaration – Executor’s Commissions and Attorney’s Fees	April 1987
4422	Application for Certificate Discharging Property Subject to Estate Tax Lien	Oct. 1986
4768	Application for Extension of Time to File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes	Jan. 2000
4810	Request for Prompt Assessment Under Internal Revenue Code Section 6501(d)	Dec. 1999
5495	Request for Discharge from Personal Liability Under Internal Revenue Code Section 6905	Oct. 1983
7990	United States Estate Tax Certificate of Discharge from Personal Liability	Sep. 1980
7990-A	United States Gift Tax Certificate of Discharge from Personal Liability	Dec. 1982
7990-B	United States Individual Income Tax Certificate of Discharge from Personal Liability	Jan. 1982
8821	Tax Information Authorization	Jan. 2000
8822	Change of Address	Oct. 2000

**NOTE:** The preceding forms can be printed from the Service’s website at “[www.irs.ustreas.gov/prod/forms\\_pubs/form.html](http://www.irs.ustreas.gov/prod/forms_pubs/form.html).”



**APPENDIX F  
USEFUL IRS PUBLICATIONS**

<b><u>Publication No.</u></b>	<b><u>Title</u></b>	<b><u>Revised</u></b>
Pub. 1	Your Rights as a Taxpayer	August 2000
Pub. 5	Your Appeal Rights and How to Prepare a Protest If You Don't Agree	Jan. 1999
Pub. 216	Conference and Practice Requirements	March 1992
Cir. 230	Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, Enrolled Actuaries, and Appraisers before the Internal Revenue Service	July 1994
Notice 433	Interest and Penalty Information	August 1999
Pub. 470	Limited Practice without Enrollment	Jan. 1982
Pub. 556	Examinations of Returns, Appeal Rights and Claims for Refund	Nov. 2000
Pub. 559	Survivors, Executors and Administrators	2000
Pub. 594	The IRS Collection Process	Jan. 2000
Pub. 721	Tax Guide for US Civil Service Retirement Benefits	2000
Pub. 901	U.S. Tax Treaties	April 2001
Pub. 939	General Rule for Pensions and Annuities	June 1997
Pub. 947	Practice before the IRS and Power of Attorney	Jan. 1999
Pub. 950	Introduction to Estate and Gift Taxes	June 1998
Pub. 1450	A Certificate of Release of Federal Tax Lien	March 1999
Pub. 1546	The Taxpayer Advocate Service of the IRS	Jan. 2001
Pub. 1660	Collection Appeal Rights	May 2000
Pub. 2193	Too Good to be True Trusts?	Nov. 1999
Pub. 3349	Modernizing America's Tax Agency	Jan. 2000
Pub. 3559	The New IRS Stands Up: What the Modernized Agency Means for You	Jan. 2000

Pub. 3618      Report on the Internal Revenue Service National Taxpayer      June 2000  
Advocate's FY 2001 Objectives

**NOTE:**      The above documents can be obtained directly from the Service's website  
located at "[www.irs.ustreas.gov/prod/forms\\_pubs/pubs.html](http://www.irs.ustreas.gov/prod/forms_pubs/pubs.html)."

**APPENDIX G**  
**RECENT CASES INVOLVING FLP'S**

*Kerr v. Commissioner*, 113 T.C. 30 (1999), Fifth Circuit Court of Appeals Docket No. 00-60903

*Church, e. al. v. United States*, 2006-1 USTC ¶ 60,369 (W.D. Tex. 2000); Fifth Circuit Court of Appeals Docket No. 00-50386

*Estate of Reichardt v. Commissioner*, 114 T.C. 144 (2000)

*Estate of Schauerhamer v. Commissioner*, T.C. Memo. 1997-242

*Estate of Nowell v. Commissioner*, T.C. Memo. 1999-15,

*W.W. Jones v. Commissioner*, 116 T.C. 121 (2001)

*Adams v. United States*, 218 F.3d 383 (5<sup>th</sup> Cir. 2000)

*Estate of Harper*, T.C.Memo. 2000-202, U.S. Tax Court Docket No. 19336-98

*Shepherd v. Commissioner*, 115 T.C. No. 30 (2000)

*Estate of Strangi v. Commissioner*, 115 T.C. 478 (2000)

*W.W. Jones v. Commissioner*, 116 T.C.No. 11 (2001)

**APPENDIX H**  
**BIBLIOGRAPHY OF USEFUL ARTICLES**

1987

Cairns & Jones, "Appraisals, Audits and Appeals – The Practical Side of Tax Practice," 12 Prob. Notes 210.

1988

Cummins, Berry & Weinberg, "Using the Service's New Handbook for Estate Tax Examiners," 68 Journal of Taxation No. 5, 276 (May).

1990

Stevenson, "Preparation, Personalities and Professionalism are Essential in Preparing for an Audit," 44 Taxation for Accountants 240 (No. 4).

1991

Schmidt & Pearson, "Preparing for an Estate Tax Examination," 19 Taxation for Lawyers 268.

1992

Newlin & Glenn, "The Estate Tax Audit: How to Prepare and Succeed," 19 Estate Planning 37 (No. 1).

1995

Gillett and Stafford, "Steps to Prepare and File Estate Tax Returns Effectively," 22 Estate Planning 164 (May/June).

1996

Ancutt, "Handling Estate Tax Disputes with the IRS," 23 Estate Planning 457 (Dec.).

David, "What You Should Know About the Taxpayer Bill of Rights 2," 11 Practical Tax Lawyer 1, 25 (Fall).

Schmudde, "A Complete Guide to Tax-Related Statutes of Limitations," 10 Practical Tax Lawyer 3, 5 (Spring).

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Lan, Jr., "What You Should Know About the IRS Appeals Process," 11 Practical Tax Lawyer 3, 49 (Spring).

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1998

David, "What You Should Know About the IRS Restructuring and Reform Act of 1998," 13 Practical Tax Lawyer 1, 5 (Fall).

1999

Berall, "Transfer Tax Procedural Changes Due to Recent Developments (with Sample Letter to a Client Facing an Income Tax Audit)," 13 Practical Tax Lawyer 3, 41 (Spring).

Carpenter, "Obtaining the Best Results in an IRS Estate Tax Audit," 26 Estate Planning No. 7, 302.

Greenhouse and Malone II, "Privilege in the IRS Audit Process – How and When Does it Apply," 91 Journal of Taxation No. 3, 133.

Lan, "Anatomy of an IRS Estate Tax Controversy: Audit to Litigation," 23<sup>rd</sup> Annual SBOT Advanced Estate Planning and Probate Course M (June).

Yale, "Valuing Assets for Form 706: Putting the 'Gross' in Gross Estate," 23<sup>rd</sup> Annual SBOT Advanced Estate Planning and Probate Course W (June).

2000

Voght and Stark, "IRS Appeals: What Kind of Hearing?," 2 Business Entities No 1, 16.

2001

David, "IRS Modernization and What it Means for Your Clients," 15 Practical Tax Lawyer 2, 39 (Winter).