Final Regulations Issued For Adequate Disclosure of Gifts

By
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When the value of a gift is adequately disclosed in a gift tax return, the Internal Revenue Service cannot revalue the gift after the expiration of the three-year statue of limitations, pursuant to Internal Revenue Code (IRC) Section 6501(c)(9). However, if the value of the gift is not shown on the return the Internal Revenue Service may assess gift tax or initiate court proceedings at any time. Before the Taxpayer Relief Act of 1997, there had to be a gift tax assessment or payment for the Internal Revenue Service to be barred from revaluing prior gifts. The primary requirement is the gift be show on the return in a manner adequate to apprise the Internal Revenue Service of the nature of the gift. Full and adequate disclosure now is the key to start the statue of limitations.

This same rule applies to the estate tax computation, as provided by IRC. Section 2001(f). Thus, gift tax values adequately reported on gift tax returns will be binding on the Internal Revenue Service in connection with the addition of taxable gifts to determine a decedent's estate tax liability, unless the Internal Revenue Service has challenged the gift tax return within the statutory period, or proves there was not adequate disclosure of the nature of the gift. This special rule is effective for decedents dying after December 31, 1997.

It should be noted that, for both gift and estate tax purposes, the statue of limitations applies only to valuation issues. If the issue is whether a gift qualifies as a "present interest," and therefore is eligible for the annual exclusion, the statue of limitations regulations will not apply.

The Internal Revenue Service has now issued final regulations providing guidance on what constitutes adequate disclosure of gifts and other transactions for this purpose (Regs. Sec. 301.6501(c)-1(e) and (f)). Under the final regulations, a transfer is adequately disclosed on the return only if it is reported in a manner adequate to apprise the Internal Revenue Service of the nature of the gift and the basis for the value reported. Transfers reported on the gift tax return as gifts are considered adequately disclosed if the return or statement attached to the return contains the following information:

- a description of the transferred property and any consideration received by the transferor;
- the identify of, and the relationship between, the transferor and each transferee;
- if the property is transferred in trust, the trust's tax identification number and either a brief description of the terms of the trust or a copy of the trust instrument;
- either a detailed description of the method used to determine the fair market value of the property transferred, including prescribed information, or an appraisal meeting stated requirements; and
- a statement describing any position taken that is contrary to any proposed, temporary, or final regulation or published revenue ruling.

The final regulations are effective for transfers of property

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by gift made after December 31, 1996, for which the gift tax return for such calendar year is filed after December 3, 1999.

Paragraph (f) (2) (iv) of the final regulations under 301.6501 (c)-1 requires a detailed description of the method used to determine the fair market value of the property transferred along with additional prescribed information. It is interesting to note that Paragraph (f) (3) allows for the submission of appraisals in lieu of the information required under Paragraph (f) (2) (iv). This part of the Regulation provides us with a clearer understanding as to Internal Revenue Service expectations concerning business appraisal reports. The appraisal meets the adequate disclosure requirements under paragraph (f) (3) if:

(i) The appraisal is prepared by an appraiser who satisfies all of the following requirements:

(A) The appraiser is an individual who holds himself or herself out to the public as an appraiser or performs appraisals on a regular basis.

(B) Because of the appraiser's qualifications, as described in the appraisal that details the appraiser's background, experience, education, and membership, if any, in professional appraisal associations, the appraiser is qualified to make appraisals of the type of property being valued.

(C) The appraiser is not the donor or the donee of the property or a member of the family of the donor or donee, as defined in section 2032A (e) (2) or any person employed by the donor, the donee, or a member of the family of either; and

(ii) The appraisal contains all of the following:

(A) The date of the transfer, the date on which the transferred property was appraised, and the purpose of the appraisal.

(B) A description of the property.

(C) A description of the appraisal process employed.

(D) A description of the assumptions, hypothetical conditions, and any limiting conditions and restrictions on the transferred property that affect the analyses, opinions, and conclusions.

(E) The information considered in determining the appraised value, including in the case of an ownership interest in a business, all financial data that was used in determining the value of the interest that is sufficiently detailed so that another person can replicate the process and arrive at the appraised value.

(F) The appraisal procedures followed, and the reasoning that supports the analyses, opinions, and conclusions.

(G) The valuation method utilized, the rationale for the valuation method, and the procedure used in determining the fair market value of the asset transferred.

(H) The specific basis for the valuation, such as specific comparable sales or transactions, sales of similar interests, asset-based approaches, merger-acquisitions transactions, etc.

Clearly, much of the language in clause (ii) appears to be taken from the Uniform Standards of Professional Appraisal Practice (USPAP) Standard 10. The information in clause (ii) (E) for the appraisal to be sufficiently detailed so another person can replicate the process and arrive at the appraisal value, can also be found in USPAP. I believe the Internal Revenue Service appears to have taken a step toward requiring appraisals of closely-held businesses, for federal taxation purposes, meet USPAP requirements. I do not believe this is to be a hardship for NACVA members, as following NACVA standards includes the above.

Conclusion: Normally, a gift tax return is not required for gifts that do not exceed the annual gift tax exclusion amount. However, the statue of limitations will not begin until a gift is adequately disclosed on a gift tax return. Therefore, when a client is gifting closely-held stock of less than $10,000 per donee ($20,000 if a split-gift is made) it is advisable to file the Federal Form 709 and attach a complete copy of the business appraisal report to the gift tax return. It is also very important that the business appraisal report meet the adequate disclosure rules. ■

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