BESSEMER TRUST

Schlapfer v. Commissioner, T.C. Memo. 2023-65

June 2023

First Reported Case With Detailed Discussion of Disclosure Requirements Under Gift Tax Adequate Disclosure Regulations; Disclosures Substantially Complied With Adequate Disclosure Requirements

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June 2, 2023

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1. Synopsis

This is the **first reported case** with a detailed discussion of the adequate disclosure requirements under the gift tax adequate disclosure regulations (Reg. §301.6501(c)-1(f)), and it applies a lenient "substantial compliance" approach (in contrast to some informal guidance from IRS attorneys that has applied a stricter approach).

Mr. Schlapfer (Donor) in 2006 (or possibly in 2007) gave to his mother, aunt, and uncle a universal variable life insurance policy funded by $50,000 and all the stock of a closely held company (EMG) that managed investments (marketable securities and cash). In 2013 Donor filed a large package of various tax returns (including a 2006 gift tax return but not a 2007 gift tax return) as part of the Offshore Voluntary Disclosure Program (OVDP) (which is no longer available). The IRS eventually assessed gift tax liability and penalties of over $8.7 million.

The court held that whether the gift was completed in 2006 or 2007 made no difference because the adequate disclosure regulations explicitly provide that disclosure of a gift as a completed gift on a gift tax return for a particular year can constitute adequate disclosure even if the gift is later determined to be incomplete in that year.

The court considered various documents in the package of returns and information submitted under the OVDP including the 2006 gift tax return, a protective filing statement attached to the return, a schedule on Form 5471 for Donor's 2006 federal income tax return, and an Offshore Entity Statement. The opinion reasons that substantial compliance, rather than strict compliance, with the adequate disclosure regulations will suffice. Donor did not strictly comply with the adequate disclosure regulations: (i) the gift was described as a gift of EMG stock rather than of the life insurance policy (which consisted primarily of the EMG stock), (ii) Donor's mother (and not also his aunt and uncle) were listed as the recipient of the gift, and (iii) there was not a statement describing how the gift was valued and the disclosure did not provide all the detailed financial information listed in Reg. §301.6501(c)-1(f)(2)(iv) (but did provide all financial documents listed in the instructions to Form 709 for close corporations). The court concluded that the disclosed information was sufficient to constitute adequate disclosure, and the assessment of additional gift taxes was barred by limitations.

Some planners view the adequate disclosure regulations as stating a general rule (the information apprises the IRS of the nature and basis of valuation of the gift) and two safe harbors – a "description safe harbor" and an "appraisal safe harbor." The court did not analyze the regulations as stating a general rule and safe harbors but analyzed whether the disclosure substantially complied with the elements of the description safe harbor. However, the opinion specifically recognized that the statement in the regulations that is viewed as the general rule is in a sentence stating that disclosure is adequate "only if" the sentence is satisfied, while the various listed "requirements" are in a sentence stating that disclosure of the listed elements "will be considered" adequate disclosure. The court viewed those elements as "not mandatory, but … as guidance to inform them on a way to satisfy adequate disclosure." That sounds like a general rule and safe harbor analysis, but the court did not use those terms. *Schlapfer v. Commissioner*, T.C. Memo. 2023-65 (Judge Buch).

2. Basic Facts

For various years, ending in 2018, the IRS offered an Offshore Voluntary Disclosure Program (OVDP) that provided taxpayers an opportunity to disclose previously unreported offshore income, assets, investments, and accounts to the IRS and resolve their foreign and U.S. tax matters. The IRS would evaluate the taxpayer's facts and circumstances and determine which penalties should apply. In exchange, the U.S. government typically would refrain from pursuing criminal prosecution.

In 2006, Mr. Schlapfer (Donor) acquired a universal variable life (UVL) insurance policy on the lives of his mother, aunt, and uncle, funded by $50,000 and all the stock of a closely held company (EMG) that managed investments (marketable securities and cash). On September 22, 2006, EMG issued a share certificate showing the policy's brokerage account as the owner of the EMG stock. The stock and cash had been fully funded to the policy's account by November 8, 2006. On January 23, 2007, Donor requested the insurance company to assign the policy to his mother, and on April 23, 2007, Donor and his mother jointly requested that the policy be assigned jointly to Donor's mother, aunt, and uncle. These changes were made on May 31, 2007.

In 2012, Donor decided to enter the OVDP, and in 2013 he submitted a disclosure packet to the OVDP that attached many documents, including various tax returns for 2004-2009. In particular, the packet included various items reporting information about the gift:

- Form 709 for 2006 reporting a gift of the EMG stock to Donor's mother;
- Attached to the Form 709 was a protective filing stating that on July 6, 2006, Donor made a gift of controlled foreign company stock valued at $6,056,686, and that Donor was "not subject to U.S. gift tax as he did not intend to reside permanently in the United States until citizenship was obtained in 2008";
- Donor reported the gift as a gift of stock rather than the policy because the 2012 OVDP instructions required taxpayers to disregard certain entities that hold underlying assets, and he thought the reporting was "in accordance with the investor control doctrine";
- Amended income tax returns for 2004-2006 that included Forms 5471 for EMG, which "provided information regarding the number and type of issued and outstanding shares, the number of shares held by [Donor], and EMG's income statement, balance sheet, and earnings and profits for the respective tax years"; and
- An Offshore Entity Statement describing the EMG gift.

After the IRS requested additional documentation, Donor submitted various documents, including a brokerage "statement showing EMG's portfolio valuation as of September 22, 2006." He also explained that he took the position that the gift was made on July 6, 2006 "when he instructed [the insurance company] to transfer ownership of the UVL policy to his mother, aunt, and uncle as soon as the policy was issued." After agreeing to a revised gift date of September 22, 2006, Donor explained that listing him as the initial owner of the policy was a scrivener's error and the transfer requests in January and April 2007 "were merely intended to correct that error."

After receiving those responses in June-July 2014, the IRS had little contact with Donor until 2016 when it opened an examination of his gift tax return. Donor agreed to extend the time to assess gift tax to November 30, **2017**.

After Donor refused to concede that the gift was made in 2007, the IRS said he could not continue in the OVDP, and he withdrew from the program. The IRS prepared a substitute gift tax return for 2007 pursuant to §6020(b) and on October 17, **2019**, issued a notice of deficiency for 2007 asserting gift tax liability of $4,429,949 and penalties under §6651(a)(2) and (f) of $4,319,200 (thus presenting Donor with an **$8.7 million** issue, **plus interest** for over 11 years).

Donor filed a petition with the Tax Court challenging the IRS's determinations. The IRS filed a motion for summary judgment finding that as a matter of law the gift the was made in 2007, and Donor was liable for penalties. Donor filed a cross motion for summary judgment requesting the court to find that the period of limitations to assess gift tax expired before the notice of deficiency was issued because Donor had adequately disclosed the gift on his 2006 gift tax return.

3. Holding

Donor adequately disclosed the gift on his 2006 gift tax return, as the Tax Court summarized:

> The documents he attached to, and referenced in, his return provided the Commissioner with enough information to satisfy adequate disclosure. Therefore, the period of limitations to assess the gift tax commenced when the return was filed; and because the Commissioner issued the notice of deficiency more than three years after the filing, the Commissioner is barred from assessing gift tax.

Whether the gift was completed in 2006 or 2007 is immaterial because "disclosure of the gift on [the] 2006 return would suffice to commence the three-year period of limitations upon the filing of that return. See Treas. Reg. §301.6501(c)-1(f)(5)."

The court therefore granted Donor's cross-motion for summary judgment and, the next day, entered an order and decision that there was no gift tax deficiency and no additions to tax.

4. Court Analysis of Adequate Disclosure

a. **Reporting of Gift Ultimately Determined To Be Incomplete in That Year.** The IRS and Donor had a big disagreement over whether the gift was made in 2006 or 2007 (because the gift was reported on a 2006 Form 709 but not a 2007 return), which resulted in Donor eventually withdrawing from the OVDP. The court determined that difference was immaterial because of explicit provisions in the Treasury Regulations providing that

> [a]dequate disclosure of *a transfer that is reported as a completed gift on the gift tax return will commence the running of the period of limitations for assessment of gift tax on the transfer, even if the transfer is ultimately determined to be an incomplete gift* for purposes of § 25.2511-2 . . . For example, if an incomplete gift is reported as a completed gift on the gift tax return and is adequately disclosed, the period for assessment of the gift tax will begin to run when the return is filed . . .

Reg. §301.6501(c)-1(f)(5) (as quoted in the opinion; emphasis is the court's).

If a gift is reported as complete and is adequately disclosed on a gift tax return, the period of limitations on assessment of additional taxes commences with the filing of that return even if the transfer is ultimately determined to be an incomplete gift.

b. **Statute.** If a gift is not reported on a gift tax return, gift taxes may be assessed at any time. The statute provides an exception for "any item which is disclosed in [a gift tax return], or in a statement attached to the return, in a manner adequate to apprise the Secretary of the nature of such item." §6501(c)(9). A similar statement is in the statute for the six-year limitations period that applies if omitted gifts exceed 25 percent of the gifts reported on a gift tax return. The six-year limitations period does not apply to any item "disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the [IRS] of the nature and amount of such item." §6501(e)(2). The court summarized the "essence" of the statute as providing the IRS "with a viable way to identify gift tax returns that should be examined with minimum expenditure of resources. T.D. 8845, 1999-2 C.B. 683."

c. **Cases.** Cases generally have looked to the purpose of disclosure, and whether disclosure is sufficient to alert the IRS whether to select a return for examination. *See Thiessen v. Commissioner*, 146 T.C. 100, 114 (2016) (quoting *Estate of Fry v. Commissioner*, 88 T.C. 1020, 1023 (1987) (cited in the *Schlapfer* opinion). [**Observation:** These are income tax cases addressing the application of the adequate disclosure exception in §6501(e)(1)(B)(iii) for purposes of the six-year limitations period where there is an omission of more than 25% of gross income. Both cases found that the taxpayer had not adequately disclosed omitted income. See Item 5.d below regarding case discussions.]

d. **Regulations.** Regulations, finalized in November 1999, are effective for gifts made after December 31, 1996.

  (1) **First Sentence – General Rule.** The first sentence of the regulation, tracking the statute, states a general rule: "A transfer will be 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 so reported." Reg. §301.6501(c)-1(f)(2).

  (2) **Second Sentence – Information So Gift "Considered Adequately Disclosed."** The next sentence provides information describing the gift and its valuation that, if disclosed, will result in a gift being "considered adequately disclosed." The opinion lists five items of information and subsequently analyzes whether those five items were supplied. The five elements in the regulation, as excerpted in the opinion, are:

> (i) A description of the transferred property and any consideration received by the transferor;

(ii) The identity of, and relationship between, the transferor and each transferee;

(iii) If the property is transferred in trust, the trust's tax identification number and a brief description of the terms of the trust, or in lieu of a brief description of the trust terms, a copy of the trust instrument;

(iv) Except as provided in §301.6501(c)-1(f)(3), a detailed description of the method used to determine the fair market value of property transferred, including any financial data (for example, balance sheets, etc. with explanations of any adjustments) that were utilized in determining the value of the interest, any restrictions on the transferred property that were considered in determining the fair market value of the property, and a description of any discounts, such as discounts for blockage, minority or fractional interests, and lack of marketability, claimed in valuing the property….; and

(v) A statement describing any position taken that is contrary to any proposed, temporary or final Treasury regulations or revenue rulings published at the time of the transfer ….

Reg. §301.6501(c)-1(f)(2).

(3) **Second Sentence "Requirements" Are Not Mandatory but Act as Guidance.** The opinion's introduction of the adequate disclosure regulation unfortunately does not refer to a general rule and a safe harbor. Some planners view the regulations as providing a general rule (apprising the IRS of the nature of the gift and the basis for its valuation) and two safe harbors: (1) a "description safe harbor," and (2) an "appraisal safe harbor." The opinion analyzes in some detail whether the elements in the "description safe harbor" are satisfied. The discussion of one of those elements, however, clearly recognizes the first sentence as a required rule and the listed elements in the second sentence as "not mandatory, but … as guidance to taxpayers to inform them on a way to satisfy adequate disclosure":

Furthermore, the Treasury Regulations provide that *[First Sentence]* "[a] transfer will be adequately disclosed . . . *only if* it is reported in a manner adequate to apprise the [IRS] of the nature of the gift . . . *[Second Sentence]* Transfers reported on the gift tax return as transfers of property by gift *will be* considered adequately disclosed . . . if the return . . . provides the following information." Treas. Reg. § 301.6501(c)-1(f)(2) (emphasis added). The difference between the wording used in these two sentences informs us that the requirements are not mandatory, but act as guidance to taxpayers to inform them on a way to satisfy adequate disclosure. (Emphasis in original.)

[**Observation:** The court's description of the first sentence of the regulation (with its "only if" statement) sounds like the description of a general rule, and the description of the second sentence (with its "will be considered adequately disclosed" statement) sounds like a safe harbor, although the court did not use those precise terms. Indeed, the court refers to the elements of what many regard as a safe harbor in the second sentence as "requirements," albeit "requirements" that it views as "not mandatory" but only as guidance of what is "sufficient to alert the [IRS] to the nature of the gift." The opinion makes no reference to the appraisal safe harbor, which is an objective way of supplying the information required in subparagraph (iv) of Reg. §301.6590(c)-1(f)(2) about the method used to value the property.]

Disclosure Contents That Can Be Considered. In this case, the gift tax return was submitted in a package with various other documents. Donor pointed to four documents, in particular, that support his claim of adequate disclosure: (1) the 2006 gift tax return; (2) a protective filing statement attached to the gift tax return; (3) Schedule F of Form 5471 for his 2006 federal income tax return; and (4) the Offshore Entity Statement. The court concluded that all these could be considered.

The court observed that "[w]hen deciding whether an item has been adequately disclosed, we may consider not only a return, but also documents attached to the return plus information documents referenced in the return." The court reasoned that the gift tax return was part of the OVDP disclosure packet with this information and the protective filing attached to the gift tax return referenced controlled foreign company (CFC) stock, "which alerted the IRS to look to the Offshore Entity Statement for information on the gift referred to in the gift tax return."

e. **Strict Versus Substantial Compliance.** The opinion concludes that substantial compliance will suffice. In the preamble to the adequate disclosure final regulations, the IRS rejected a recommendation that the regulations should expressly allow substantial compliance because of the difficulty in defining and illustrating what would constitute substantial compliance. T.D. 8845, 1999-2

C.B. at 685. However, the preamble said its rejection of that recommendation did not mean "that the absence of any particular item or items would necessarily preclude satisfaction of the regulatory requirements, depending on the nature of the item omitted and the overall adequacy of the information provided."

The court viewed that statement as acceptance by the Department of Treasury of "the very essence of substantial compliance. Therefore, we conclude that the adequate disclosure requirements can be satisfied by substantial compliance."

f. **Substantial Compliance with Elements of the Description "Requirements."**

(1) **Description of Property and Consideration Received.** Donor actually gave the UVL policy, but the gift tax return, protective filing, Offshore Entity Statement, and Form 5471 for the 2006 income tax return described the gift of EMG shares valued at $6,056,686 to his mother on July 6, 2006, and described the number and type of EMG shares. Donor did not strictly comply with the description "requirement" because he did not reference or describe a transfer of a life insurance policy. However, Donor substantially complied sufficient to alert the IRS to the nature of the gift.

> As previously mentioned, disclosure is adequate if it is sufficiently detailed to alert the Commissioner to the nature of the transaction so that the decision to select a return for audit is reasonably informed. *Thiessen*, 146 T.C. at 114. …
>
> Mr. Schlapfer provided enough information to satisfy this requirement through substantial compliance. While he may have failed to describe the gift in the correct way (assuming the gift is the UVL Policy), he did provide information to describe the underlying property that was transferred. Mr. Schlapfer asserts that he chose to disclose the assets held in the insurance policy instead of the actual policy because the OVDP required him to disregard entities holding foreign assets. The UVL Policy's value comes primarily from EMG stock, so Mr. Schlapfer's describing the transferred property as EMG stock goes to the nature of the gift. Because this description was sufficient to alert the Commissioner to the nature of the gift, Mr. Schlapfer substantially complied with this requirement.

(2) **Identity of Parties.** Donor did not strictly comply with the "requirement" of identifying the identity of, and his relationship to, each transferee. The Offshore Entity Statement stated that the gift was made to Donor's mother, with no mention of his aunt or uncle. Nevertheless, Donor substantially complied with this "requirement." The statement listing Donor's mother as the transferee provided the IRS with enough information to understand the donee was a "member of his family," and failing to provide the names of his aunt and uncle "does not make a meaningful difference in understanding the nature of the transfer."

(3) **Method to Determine Value of Gift.** The regulation refers to providing "a detailed description of the method used to determine the fair market value of property transferred, including" considerable detailed information for different types of property. Donor did not provide any statement describing how he valued the fair market value of the gift. Also, he did not provide all the detailed financial information listed in the regulation, but he did provide all documents listed in the instructions to Form 709 for stock of close corporations ("attach balances sheets, particularly the one nearest the date of the gift, and statements of net earnings or operating results and dividends paid for each of the 5 preceding years"). That was enough to show the IRS how he valued the EMG stock, and the UVL policy value stems primarily from the EMG stock, so he substantially complied with this "requirement":

> Although Mr. Schlapfer did not provide all the financial documentation listed in the regulation, he provided the information identified in the 2006 Form 709 instructions, which was enough to show the IRS how he determined the fair market value of the EMG stock. Therefore, he substantially complied with this requirement.
>
> Furthermore, Mr. Schlapfer substantially complied even if the gift is the UVL Policy. The UVL Policy's principal asset is the EMG stock, and the documents we considered above were enough to apprise the Commissioner of the method used to determine the fair market value of the EMG stock. Because the UVL Policy's value stems primarily from the EMG stock, those same documents can be used to illustrate the method used to determine the fair market value of the UVL Policy.

5. Observations

a. **Most Attractive Aspect of Opinion (From Taxpayer Perspective).** The IRS has been aggressive in applying the adequate disclosure requirements strictly, to prevent the running of the gift tax statute of limitations. IRS notices and informal guidance have generally been very strict (and sometimes harsh) in applying the requirements, including treating the elements of the safe harbors in the regulations as mandatory requirements. This case is the **first case** to address in any detail what constitutes substantial compliance with the adequate disclosure regulations. The case takes a **very reasonable approach** to finding that substantial compliance exists despite various instances of failing to comply with the guidelines in the regulations. There have been few cases discussing the gift tax adequate disclosure regulation.

   The case also recognizes that the various elements of what is known as the "description safe harbor" are not mandatory requirements but merely "guidance to taxpayers to inform them on a way to satisfy adequate disclosure."

b. **Most Concerning Aspect of Opinion (From Taxpayer Perspective).** Unfortunately, the case does not clearly analyze the adequate disclosure regulations as stating a general rule (apprising the IRS of the nature of the gift and the basis for its valuation) and two safe harbors: (1) a "description safe harbor," and (2) an "appraisal safe harbor." All the detailed elements of either safe harbor would not necessarily have to be satisfied in order to satisfy the general rule. Even though the court does not use the terms general rule and safe harbors, the court's analysis has the same general effect. It recognizes that the detailed "requirements" of the "description safe harbor" are not mandatory but merely "guidance [of] a way to satisfy adequate disclosure."

   In any event, the court did not discuss directly whether the disclosure was sufficient to "apprise the Internal Revenue Service of the nature of the gift and the basis for the value so reported" aside from other "requirements."

c. **A Little History; Taxpayer Relief Act of 1997.** The Taxpayer Relief Act of 1997 made substantial changes to the statute of limitations applicable for gift taxes and for determining the amount of adjustable taxable gifts for estate tax purposes.

   (1) **Unlimited Period of Assessment for Gifts Not Adequately Disclosed.** The Omnibus Budget Reconciliation Act of 1990, while adding Chapter 14 to the Code, also added §6501(c)(9), providing an unlimited period for assessment of gift tax for gifts valued under §2701 or §2702 that were not adequately disclosed on a gift tax return. The 1997 Act amended §6501(c)(9), effective for all gifts after 1996, to extend the unlimited period of assessment for gift taxes to all gifts that are not adequately disclosed on a gift tax return, even if a return was filed for the year but did not adequately disclose such particular gifts.

   (2) **No Requirement To Pay Gift Tax To Commence Period of Limitations.** Prior to the 1997 Act, the three-year statute of limitations, for assessment of gift tax and for determining the amount of gifts in preceding calendar quarters, would begin to run on gifts in a year in which a gift tax return was filed *and gift tax was paid*. §2504(c). Effective for gifts made after August 5, 1997, the requirement of paying gift tax for limitations to begin running was deleted.

   (3) **No Revaluation for Estate Tax Purposes.** Prior to the 1997 Act, gifts could be revalued at the donor's death for purposes of determining the amount of adjusted taxable gifts added into the estate tax calculation, but the effect was merely possibly to push the estate into higher estate tax brackets. *Estate of Smith v. Commissioner*, 94 T.C. 872 (1990), *acq*. 1990-2 C.B. 1. The 1997 Act changed that and provides that gifts adequately disclosed on a gift tax return and for which the period of limitations on assessment of gift tax has run cannot be revalued for estate tax purposes. §2001(f) (effective for gifts made after August 5, 1997).

   (4) **Regulations.** Regulations were proposed to implement the changes under the 1997 Act on December 21, 1998, and were finalized on November 18, 1999. The proposed regulation had stated that a gift would be adequately disclosed "only if" specified information is included in the return. This was changed in the final regulations, which require that a gift be reported "in a

manner adequate to apprise the Internal Revenue Service of the nature of the gift and basis for the value so reported." Reg. §301.6501(c)-1(f)(2). The next sentence says that gifts "will be considered adequately disclosed" if the return provides the information listed in five subparagraphs.

(5) **Resource.** For a detailed discussion of the history of the Taxpayer Relief Act of 1997 and the adequate disclosure regulations, see Ronald Aucutt, The Statute of Limitations and Disclosure Rules for Gifts (July 2022), found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**).

d. **Prior Cases.** This is the **first reported case** with a detailed analysis of the requirements for adequate disclosure under Reg. §301.6501(c)-1(f)(2). Many cases, though, have discussed the six-year statutes for substantial omissions of gross income (now §6501(e)(1)(B)(iii) or of gross estate assets or gifts (§6501(e)(2)) with their similar exception for adequate disclosures.

(1) **Income Tax Cases**. The Supreme Court, in addressing a situation governed by the predecessor of §6501, referred to the fact that "the return on its face provides **no clue** to the existence of the omitted item." *The Colony, Inc. v. Commissioner*, 357 U.S. 28, 36 (1958) (emphasis added).

An oft-quoted case is *George Edward Quick Trust v. Commissioner*, 54 T.C. 1336 (1970), *aff'd on other grounds*, 444 F.2d 90 (8th Cir. 1971). That case held that a partnership's receivables for services constituted income in respect of a decedent, and a §754 election for the partnership did not result in a basis increase for the receivables attributable to the estate's interest in the partnership. A second issue was whether a deficiency was time barred by the three-year period of limitations or open to adjustment under the six-year period of limitations for substantial omissions of gross income if the income was not adequately disclosed. The court held that the estate's and partnership's income tax returns could both be considered. The court reasoned that a schedule on the partnership return revealed distributions of ordinary income of $1,561.13 (which the partnership had calculated incorrectly assuming a basis increase had occurred for the receivables) and also reported withdrawals by, and distributions to, the estate of $32,587.50. The difference between those numbers exceeded the additional amount of asserted income that should have been reported.

> Under these circumstances, we think that the "amount" of the omitted income was sufficiently disclosed. Nothing in the statute requires disclosure of the exact amount. See *Cardinal Life Insurance Co.* v. *United States*, 300 F. Supp. 387, 393 (N.D. Tex. 1969) [footnote omitted]. **The touchstone in cases of this type is whether respondent has been furnished with a "clue" to the existence of the error.** See *Benderoff* v. *United States*, 398 F. 2d 132, 136 (C.A. 8, 1968); *Louis Lesser*, 47 T.C. 564, 590 (1967); see also *Colony, Inc.* v. *Commissioner*, 357 U.S. 28, 36 (1958). **Concededly, this does not mean simply a "clue" which would be sufficient to intrigue a Sherlock Holmes. But neither does it mean a detailed revelation of each and every underlying fact.**
>
> The respondent had clear notice that the estate received from the partnership an amount far in excess of the amount reported on the estate's return. We think that this, together with the information revealed by the balance sheet on the partnership return, constituted compliance with the statutory requirement. Consequently, we hold that the year 1961 is barred. *Colony, Inc.* v. *Commissioner, supra; Benderoff* v. *United States, supra; Genevieve B. Walker*, 46 T.C. 630 (1966). (Emphasis added.)

The *Schlapfer* opinion cites *Thiessen v. Commissioner*, 146 T.C. 100 (2016), and *Fry v. Commissioner*, 88 T.C. 1020 (1987). Both of those cases also involved the income tax six-year period of limitations adequate disclosure exception. *Thiessen* concluded that the income tax return "offers not even a clue as to the existence, nature, or amount of any omitted income." The *Thiessen* court described the standard for testing adequate disclosure as follows.

> A disclosure is "adequate" if it is "sufficiently detailed to alert the Commissioner and his agents as to the nature of the transaction so that the decision as to whether to select the return for audit may be a reasonably informed one." Estate of Fry v. Commissioner, 88 T.C. 1020, 1023 (1987); see also Colony, Inc. v. Commissioner, 357 U.S. 28, 36 (1958). The disclosure need not detail every underlying fact but must be more substantial than simply providing a clue that would intrigue the likes of Sherlock Holmes. See Quick's Tr. v. Commissioner, 54 T.C. 1336, 1347 (1970), aff'd, 444 F.2d 90 (8th Cir. 1971); see also White v. Commissioner, 991 F.2d 657, 661-662 (10th Cir. 1993), aff'g T.C. Memo. 1991-552. The test is whether a

reasonable person would discern from the return that the disputed gross income is omitted. See Univ. Country Club, Inc. v. Commissioner, 64 T.C. 460, 471 (1975).

In *Fry*, the return included a statement describing a sale of stock, presumably to an unrelated party, without disclosing that it was a redemption transaction (which involves possible dividend consequences and warrants "special scrutiny" as a transaction between a corporation and one of its two equal shareholders). If the transaction had been described as a redemption, "the clue would have been fully sufficient to invoke the [adequate disclosure] exception." The *Fry* court stated this as its standard for adequate disclosure:

> The statement must be sufficiently detailed to alert the Commissioner and his agents as to the nature of the transaction so that the decision as to whether to select the return for audit may be a reasonably informed one. *Benderoff v. United States,* [398 F.2d 132 (8th Cir. 1968)].

(2) **Estate Tax Case**. Section 6501(e)(2) provides a six-year limitations period for assessing estate or gift tax if there have been substantial omissions of more than 25 percent of the reported gross estate or gifts, and it includes an adequate disclosure exception similar to the six-year income tax statute discussed above. *Estate of Williamson v. Commissioner*, T.C. Memo. 1996-426, analyzed §6501(e)(2) by looking to the standards described in the parallel six-year limitations period for substantial omissions of income in §6501(e)(1):

> Although no estate tax cases have been found interpreting section 6501(e)(2) of the code [footnote omitted], an examination of section 6501(e)(1) and (2) shows that the two are in pari materia in dealing with the same subject — the application of the statute of limitations — and, accordingly, we may give due consideration to income tax cases in deciding estate tax cases on this same subject.
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> …
>
> This Court has interpreted the Supreme Court's "clue" standard to mean not "a detailed revelation of each and every underlying fact", but also that it "does not simply mean a clue which would be sufficient to intrigue a Sherlock Holmes." Quick Trust v. Commissioner, 54 T.C. 1336, 1347 (1970), affd. 444 F.2d 90 (8th Cir. 1971). Furthermore, in interpreting this statutory language (common to both income and estate tax provisions) in section 6501(e), relating to the omission as "disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary of the nature and amount of such item", we have held that disclosure of the omitted material is adequate, even without disclosing exact dollar amounts. Quick Trust v. Commissioner, supra; University Country Club, Inc. v. Commissioner, 64 T.C. 460, 470 (1975); Morris v. Commissioner, T.C. Memo. 1966-245. The disclosure statement however must be sufficiently detailed so that a decision whether to select the return for audit may be a reasonably informed one. Estate of Frane v. Commissioner, 98 T.C. 341, 355 (1992), affd. in part and revd. in part 998 F.2d 567 (8th Cir. 1993).

Estate of Williamson pointed to a statement in the extension request for filing the estate tax return that a reason for the delay was the inability to list and value items in the estate because of a dispute between the estate and the surviving husband. That statement was attached to the estate tax return when filed. The court concluded that gave "adequate notification" to the IRS of the reasons for failing to itemize and value specific items, and therefore the six-year statute did not apply.

(3) **Gift Tax Cases**. Several gift tax cases have addressed the six-year limitations period for substantial omissions of more than 25% of gifts reported on a gift tax return in §6501(e)(2), but without any detailed discussion of the standard for adequate disclosure. *Daniels v. Commissioner*, T.C. Memo. 1994-591 (no gift was omitted but the dispute was merely over the value of gift arising from the reported transaction); *Estate of Robinson v. Commissioner*, 101 T.C. 499, 516 (1993) (incorrectly claiming excess annual exclusions is not the omission of a gift, so the six-year limitations period did not apply).

Other cases have touched on §6501(c)(9) (as amended in 1997), but without any detailed discussion of the standards for adequate disclosure. *Estate of Sanders v. Commissioner*, T.C. Memo 2014-100 (denied executor's motion for summary judgment that assessment of additional gift tax for gifts made by the deceased donor was time barred; a genuine dispute of material fact existed as to whether gift tax returns adequately disclosed the nature of gifted stock and the basis of its valuation; IRS contended that the returns failed to disclose the company's ownership of another closely-held entity); *Estate of Brown v. Commissioner*, T.C. Memo. 2013-50 (decedent as trustee of marital trust reported related-party installment sales on the trust's income tax return but did not report the transaction on a gift tax return; court cited §6501(c)(9) and Reg. §301.6501(c)-1(f)(4) but without any significant discussion of the adequate disclosure standards).

e. **IRS Guidance.** Informal IRS guidance from the IRS Chief Counsel's office or from IRS field attorneys have viewed the safe harbors in the adequate disclosure regulations as if they were substantive requirements rather than safe harbors for satisfying the general rule.

- Chief Counsel Advice 200221010 (gift was made before the effective date of the adequate disclosure regulation but "the principles upon which [the regulations] are based are implicit in section 6501(c)(9) itself"; return did not have an adequate description of the gifts because it did not describe the number of units of the LLC that were transferred, the percentage of ownership those units represented, or the nature of the Class B interests; the Advice was issued less than a month after the three-year statute ran, suggesting that the gift must have been under examination before that time, so apparently there was enough information on the return to alert the IRS it should be selected for examination, which is the general purpose of the adequate disclosure exception).
- Chief Counsel Advice 201024059 (referencing §6501(c)(9) but with little analysis of the requirements for adequate disclosure).
- Legal Advice Issued by Field Attorneys (LAFA) 20152201F (description safe harbor "requirements" not satisfied; names of partnerships were abbreviated, "LP" and "LLP" designations were omitted from the names of the partnerships, the return describes the transfer of "partnership interests" without explaining whether they were general, limited, or limited liability interests, employer identification number of one partnership was missing a digit, appraisals attached to the return valued the land held by each partnership but not the partnership interests themselves; acknowledged that IRS bears burden of proving that an exception to the three-year state of limitations applies).
- Legal Advice Issued by Field Attorneys (LAFA) 20172801F (no gift tax returns filed for years 1-6 and return for year 7 did not describe property transferred or a description of the method used to determine the value of that property).

These Advice documents are all described in more detail in Ronald Aucutt, The Statute of Limitations and Disclosure Rules for Gifts (July 2022), found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**).

f. **Safe Harbors in Adequate Disclosure Regulation.**

(1) **Description Safe Harbor.** The five elements of the description safe harbor are listed in Item 4.d(2) above, as summarized in the *Schlapfer* opinion.

(2) **Appraisal Safe Harbor.** The appraisal safe harbor is a way of satisfying the fourth sub-paragraph (the method to determine fair market value). Reg. §301.6501(c)-1(f)(3). The remaining elements of the description safe harbor (in Reg. §301.6501(c)-1(f)(2) (i)-(iii), (v)) are also applicable. The Appraisal Safe Harbor regulation provides details about who are qualified appraisers and the appraisal contents. The appraisal safe harbor may be a more objective way of supplying information about the method to determine the fair market value of property than the more generic information about fair market value listed in the description safe harbor.

(3) **Approaches for Satisfying the Appraisal Safe Harbor.** The appraisal safe harbor specifies that the appraisal, among other things, contain "[t]he date of the transfer, the date on which the transferred property was appraised, and the purpose of the appraisal." Reg. §301.6501(c)-1(f)(3)(ii)(A). But if a donor wants to make a gift of a certain value (or approximate value), how does the donor proceed? As a practical matter, the appraisal cannot possibly appraise the asset as of the date of the gift and be written and delivered on the same day prior to the gift later in the day. Alternatives include:

- Use an appraisal dated as close in time to the gift as possible (assuming economic conditions have not changed) and be ready to argue that the information is sufficient to satisfy the general rule of the adequate disclosure regulations (apprising the IRS of the nature and basis of valuation of the gift), or that the disclosure substantially complies with the appraisal safe harbor.
- Use a *Wandry* transfer on the date of the gift and obtain an appraisal later appraising the asset as of that date (to determine an estimate of the number of units transferred to include on the gift tax return before the value is finally determined for gift tax purposes). *See Wandry v. Commissioner*, T.C. Memo. 2012-88.
- Use a *Nelson* formula transfer, transferring assets having a specific value as determined by an appraisal by a designated appraisal firm to be completed within, say, 90 days after the transfer. *See Nelson v. Commissioner*, 128 AFTR 2d 2021-6532, Cause No. 20-61068 (5th Cir. November 3, 2021), *aff'g*, T.C. Memo. 2020-81. The IRS does not find that abusive. By the time the gift tax return is filed, the appraisal report will have been delivered and the precise number of shares that were transferred will be known and reported on the gift tax return. Obviously, that approach provides no protection against additional gift taxes in the event of an examination. The key distinction from a classic defined value type of transfer is that the formula number of units being transferred is determined by an appraisal withing 90 days of the gift, not by values as finally determined for federal gift tax purposes. For a summary of *Nelson*, see Item 11 of Estate Planning Current Developments and Hot Topics for 2022 (December 2022) found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights.**
- Obtain an appraisal before the gift is made, transfer the number of assets required to equal the targeted gift amount based on the value in that appraisal, and negotiate with the appraiser to update the appraisal as of the actual date of the transfer. Most appraisers will do that for a small additional fee (assuming major economic changes have not occurred in the meantime).
- Alternatively, negotiate for the appraiser to simply re-issue the appraisal and add a sentence stating the date of the transaction. The safe harbor regulation does not require that the appraisal be prepared as of the transaction date but merely that the appraisal state "[t]he date of the transfer, the date on which the transferred property was appraised, and the purpose of the appraisal." However, if economic conditions have changed in the meantime, reliance on the appraisal prepared as of the prior date may not be deemed to be reasonable.

g. **Non-Gift Transactions.** Many planners encourage clients to file gift tax returns to report non-gift transactions (e.g., sales) to start the statute of limitations. Otherwise, the possibility of owing gift tax on an old transaction is always present.

The adequate disclosure regulations expressly permit reporting non-gift completed transfers to start the statute of limitations in case the IRS were to later assert that the transaction had a gift element. That is permitted even if a gift tax return would not otherwise be required. Examples include sales purportedly for full value, transfers qualifying for the annual exclusion (Reg. §301.6501(c)-1(f)(7), Ex.2), transfers made in the ordinary course of business (Reg. §301.6501(c)-1(f)(7), Ex. 6), or transfers reported as complete but that are determined to be incomplete because of a retained power or interest (Reg. §301.6501(c)-1(f)(5)).

h. **Split Gifts.** For split gifts under §2513, compliance with the adequate disclosure requirements by the donor spouse will be treated as adequate disclosure by the consenting spouse. §301.6501(c)-1(f)(6).

i. **Late Disclosure.** Disclosure to start the gift tax statute of limitations must be made "on a gift tax return … or a statement attached to the return." §301.6501(c)-1(f)(1). If a gift tax return does not make adequate disclosure, how can that be corrected since the gift tax rules do not specifically authorize amended gift tax returns? Rev. Proc. 2000-34, 2000-2 C.B. 186, provides the answer. An amended return may be filed (i) with a special caption at the top of the return, (ii) identifying the transfer in question, and (iii) supplying the additional information to constitute adequate disclosure. The amended return procedures do not apply to fraudulent returns or to willful attempts to evade tax. Rev. Proc. 2000-34 applies to amended returns filed beginning August 22, 2000.