

IRS Sets Requirements for Adequate Disclosure of Gifts

In December 1999, the IRS amended certain sections of the Internal Revenue Code to state that the period of limitations on assessment for gift taxes--usually three years--will only start running if the gift is adequately disclosed on the gift tax return. In other words, if the donor of the gift is able to meet the requirements of adequate disclosure, their exposure for additional taxation on that gift will be limited to three years.

The IRS states that its rationale for adequate disclosure is to allow itself a viable means to identify the returns that should be examined or those that do not require examination, with a minimum expenditure of taxpayer time and money. In order for any gifts made after December 31, 1999 to be adequately disclosed, certain information must be submitted either by the donor or by a qualified appraiser. This required information is essentially the same regardless if it is supplied by the donor or the qualified appraiser. In general, a gift will be adequately disclosed if the transferred property is described, the relationship between the transferor and transferee is indicated and a detailed description of the method used to determine fair market value is provided, including financial data and a description of discounts taken.

Additional elements of the ruling make it easier for taxpayers or their business appraisers to meet the adequate disclosure requirements. For example, the IRS originally indicated that if a less-than-100 percent interest in a privately held asset is transferred or gifted, the taxpayer must submit a value based on the pro-rated share of 100 percent of the company without regard to

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any discounts.

Based on discussion and input from experts in the valuation community, the final ruling states that the taxpayer is not required to submit the value of 100 percent of the company, without regard to any discounts, provided the lesser interest in the company is properly determined without using the net asset value of the entire company. Similarly, taxpayers are only required to submit information about lower-tiered entities when that information is relevant and material in determining the value of the interest that was transferred.

Full and adequate disclosure is the key to start the statute of limitations running. If the IRS does not challenge the values on a gift tax return during this three year period, then the IRS may not adjust the amount of the gift in determining future gift and estate tax liability. Therefore, it is obviously in the taxpayer's best interest to meet all of the requirements of the adequate disclosure rules; using a qualified appraiser is one means to this end.

Final Regulations

Section 301.6501 (c)-1 Exceptions to general period of limitations on assessments and collections. (As published in the [Federal Register](#): December 3, 1999 (Vol. 64, No. 232))

- (e) Gifts subject to chapter 14 of the Internal Revenue code not adequately disclosed on the return.
- (f) Gifts made after December 31, 1996, not adequately disclosed on the return.
 - (1) In general. If a transfer of property, other than a transfer described in paragraph (e) of this section, is not adequately disclosed on a gift tax return (Form 709 "United States Gift and Generation-Skipping Transfer Tax Return), or in a statement attached to the return, filed for the calendar period in which the transfer occurs, then any gift tax imposed by chapter 12 of subtitle B of the Internal Revenue Code on the transfer may be assessed, or a proceeding in the court for collection of the appropriate tax may be begun without assessment, at any time.
 - (2) Adequate disclosure of transfers of property reported as gifts. 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. Transfers reported on the gift tax return as transfers of property by gift will be considered adequately disclosed under this paragraph (f) (2) if the return (or statement attached to the return) provides the following information:
 - (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 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 section 301.6501-1(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. In the case of a transfer of an interest that is actively traded on an established exchange, such as the New



York Stock Exchange, The American Stock Exchange, the NASDAQ National Market, or a regional exchange in which quotations are published on a daily basis, including foreign exchanges, recitation of the exchange where the interest is listed, the CUSIP number of the security, and the mean between the highest and lowest quoted selling prices on the applicable valuation date will satisfy all of the requirements of this paragraph (f) (2) (iv). In the case of the transfer of an interest in an entity (for example, a corporation or partnership) that is not actively traded, a description must be provided of any discount claimed in valuing the interests in the entity or any assets owned by such entity. In addition, if the value of the entity or of the interests in the entity is properly determined based on the net value of the assets held by the entity, a statement must be provided regarding the fair market value of 100% of the entity (determined without regard to any discounts in valuing the entity or any assets owned by the entity) the pro rata portion of the entity subject to the transfer, and the fair market value of the transferred interest as reported on the return. If 100 percent of the value of the entity is not disclosed, the taxpayer bears the burden of demonstrating that the fair market value of the entity is properly determined by a method other than a method based on the net asset value of the assets held by the entity. If the entity that is the subject of the transfer owns an interest in another non-actively traded entity (either directly or through ownership of an entity), the information required in this paragraph (f) (2) (iv) must be provided for each entity if the information is relevant and material in determining the value of the interest; 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.
- (3) Submission of appraisals in lieu of the information required under paragraph (f)(2)(iv) of this section. The requirements of paragraph (f)(2)(iv) of this section will be satisfied if the donor submits an appraisal of the transferred property that meets the following requirements:
- (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;
 - (ii) The appraisal is prepared by an appraiser who satisfies all of the following requirements:
 - (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-acquisition transactions, etc.