



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL OFFICE CHIEF COUNSEL ADVICE

MEMORANDUM FOR: ASSOCIATE AREA COUNSEL - Area 4
(Large and Mid-Size Business)
CC:LMSB:NR:4

FROM: Assistant Chief Counsel (Administrative Provisions &
Judicial Practice) CC:PA:APJP

SUBJECT: Gift Tax Exceptions to the 3 Year Period of Limitations

This Chief Counsel Advice responds to your memorandum dated November 7, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

LEGEND

Taxpayer =
Taxpayer's Wife =
ABC LLC =

ISSUES

1. Whether Taxpayer's gift tax return failed to show a gift such that the period of limitations is held open pursuant to I.R.C. § 6501(c)(9) with respect to Taxpayer's gift tax return.
2. Whether Taxpayer's gift tax return contained a substantial omission such that the period of limitations is held open pursuant to I.R.C. § 6501(e)(2) with respect to Taxpayer's gift tax return.

CONCLUSIONS

Section 6501(c)(9) provides an exception to the general 3-year period of limitations in the case of gift tax on certain gifts not shown on a gift tax return. In addition, section 6501(e)(2) provides an exception to the general 3-year period of limitations in the case of a gift tax return with a substantial omission. We conclude that

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Taxpayer did not disclose the gifts in a manner adequate to apprise the Service of the nature and amount of the gifts. Therefore, Taxpayer's period of limitations is held open indefinitely in accordance with section 6501(c)(9). In the alternative, Taxpayer's period of limitations is held open for 6 years in accordance with section 6501(e)(2).

FACTS

ABC LLC was formed in 1997 as a limited liability company under Delaware law and treated as a partnership for federal tax purposes. At the time of formation, Taxpayer was a member in ABC LLC and held a 1% interest. Through a series of transactions not relevant to the determination of the issues in this case, Taxpayer acquired an additional 19% interest in ABC LLC. Taxpayer's entire 20% interest was composed of Class B units.

On April 7, 1997, Taxpayer gifted the 19% interest in ABC LLC to a generation-skipping trust. On that same day, Taxpayer gifted the remaining 1% interest in ABC LLC to a family trust. Taxpayer and Taxpayer's Wife split the value of both gifts in accordance with section 2513 of the Internal Revenue Code. Taxpayer filed his gift tax return (Form 709) on October 9, 1998 and attached the following description of the gifts: "Class B units in ABC LLC. Units acquired on 4/6/97 for \$200,000 cash." In addition, Taxpayer indicated that the gifts were made on 4/7/97 with a value on that date of \$200,000 and an adjusted basis of \$200,000. Taxpayer's Form 709 was due on April 15, 1998 and therefore was not timely filed.

The Service maintains that the fair market value of Taxpayer's transfers to the two trusts at the time of the transfers was \$14 million. The Service proposes to issue a notice of deficiency to Taxpayer for the 1997 tax year for the deficiency in gift tax. The Service has raised the question of whether it may rely on the exception for gifts not adequately shown on a return as a defense to the argument that the period of limitations for assessing deficiencies has expired with respect to Taxpayer's 1997 gift tax liability. In the alternative, the Service has raised the question of whether it may rely on the exception for a substantial omission of gifts as a defense to the argument that the period of limitations for assessing deficiencies has expired with respect to Taxpayer's 1997 gift tax liability.

LAW AND ANALYSIS

Section 6501 of the Internal Revenue Code provides that, except as otherwise provided, tax must be assessed within 3 years after the return was filed, whether or not such return was filed on or after the date prescribed. As an exception, section 6501(c)(9) extends the period of limitations indefinitely if a gift of property, the value of which is required to be shown on a gift tax return, is not shown on such return. This exception does not apply, however, "to any item which is disclosed in such return, or in a statement attached to the return, in a manner adequate to

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apprise the Secretary of the nature of such item.” I.R.C. § 6501(c)(9). Thus, to obtain the benefit of the exception in section 6501(c)(9), the Service must show: (1) that the value of the gift was required to be shown on a gift tax return; and (2) the gift was not disclosed in the gift tax return or in any statement attached to the return in a manner sufficient to apprise the Service of the nature of the gift.

As another exception, section 6501(e)(2) extends the period of limitations to 6 years where the taxpayer omits from the total amount of gifts made during the period for which the gift tax return was filed an amount which exceeds 25% of the total amount of gifts stated on the return. In determining the items omitted from the total gifts, there shall not be taken into account any item which is omitted from the total gifts stated in the return “if such item is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Service of the nature and amount of such item.” I.R.C. § 6501(e)(2). In addition, when determining whether a 25% omission exists, any increases in the valuation of assets disclosed on the gift tax return are not taken into account. Treas. Reg. § 301.6501(e)-1(b)(2). Thus, to obtain the benefit of the exception in section 6501(e)(2), the Service must show: (1) that the omitted items were properly includible in total gifts for the calendar year, (2) the omitted items comprised more than 25% of the total gifts shown on the return, and (3) the information on the gift tax return or on any statement attached to the return was not sufficient to apprise the Service of the nature and amount of the omitted item.

Neither the Code nor the Treasury regulations provide guidance on what constitutes “a manner adequate to apprise the Service of the nature and amount of such item.” Moreover, we have found no gift tax cases interpreting the adequate disclosure standards of sections 6501(c)(9) or 6501(e)(2). However, we note that section 6501(e)(1) provides a similar exception to the period of limitations for a substantial omission of items in the income tax context and section 6501(e)(1)(A)(ii) contains identical language regarding adequate disclosure. The Tax Court has recognized that “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.” Estate of Williamson v. Commissioner, T.C. Memo. 1996-426. While this decision was in the context of the period of limitations exception for the substantial omission of items from the gross estate, we see no reason why the same standard should not apply in the gift tax context. Moreover, the legislative history for section 6501(e)(2) indicates that section 6501(e)(2) “applies to estate and gift taxes a rule, corresponding to the income-tax rule.” S. Rep. No. 83-1622, at 584 (1954); H.R. Rep. No. 83-1337, at 414 (1954). In addition, because section 6501(c)(9) also utilizes the “manner adequate to apprise the Secretary” language, we believe the same adequate disclosure standard should apply. Thus, income tax cases construing the adequate disclosure standard in the context of a substantial omission of items can be used as guidance for determining whether there has been adequate disclosure for purposes

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of sections 6501(c)(9) and 6501(e)(2).

The disclosure required to trigger section 6501(e)(1) and avoid application of the extended period of limitations has been held to require production of a “clue” with respect to the omission of income. University Country Club, Inc. v. Commissioner, 64 T.C. 460, 470 (1975). “[T]his 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.” George Edward Quick Trust v. Commissioner, 54 T.C. 1336 (1970), aff’d per curiam, 444 F.2d 90 (8th Cir. 1971). The disclosure must be sufficiently detailed that a decision whether to select the return for audit may be a reasonably informed one. Estate of Fry v. Commissioner, 88 T.C. 1020, 1023 (1987) (citation omitted). Moreover, the 6-year period of limitations applies where there is either a complete omission of an item of the requisite amount or misstating of the nature of an item. Phinney v. Chambers, 392 F.2d 680, 685 (5th Cir. 1968). In either situation, the Service is at a disadvantage in detecting errors and consequently needs more time to uncover those errors. Id.

Turning now to the question of whether there was sufficient information on Taxpayer’s gift tax return to apprise the Service of the nature of the interests in ABC LLC, we note that the regulations that correspond with section 6501(c)(9) contain detailed guidance on what constitutes adequate disclosure of transfers of property reported as gifts. In this regard, Treas. Reg. § 301.6501(c)-1(e) sets detailed guidelines for a transfer of property subject to the special valuation rules of section 2701 or section 2701, while Treas. Reg.

§ 301.6501(c)-1(f) sets detailed guidelines for gifts made after December 31, 1996 not adequately disclosed on a return filed after December 3, 1999. Based on the facts submitted, we cannot determine whether Taxpayer’s transfers of interests in ABC LLC were subject to the special valuation rules of sections 2701 or 2702. Thus, we cannot determine whether the adequate disclosure standard of Treas. Reg. § 301.6501(c)-1(e) is applicable in this case. Moreover, we note that Taxpayer and Taxpayer’s Wife filed gift tax returns for the 1997 calendar year prior to December 3, 1999, (the effective date of the regulations) making Treas. Reg. § 301.6501(c)-1(f) also inapplicable. See Treas. Reg.

§ 301.6501(c)-1(f)(8). Nonetheless, both regulations illustrate the type of information that should be on the return (or a statement attached thereto) for the return to commence the running of the period of limitations on assessment. In particular, a gift tax return (or statement attached thereto) should contain, at a minimum, a description of the transferred property, the identity of the transferor and each transferee, the relationship between those parties, and a description of the method used to determine the value of the gift. In addition, for a transfer of property in trust, the gift tax return should contain a description of the terms of the trust. Moreover, the Service has indicated that where a donor files a gift tax return but fails to adequately disclose a gift because the information required under Treas.

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Reg. § 301.6501(c)-1(f)(2) for the gift was not submitted with the return, the period of limitations on assessment with respect to that return does not begin to run. Rev. Proc. 2000-34, 2000-2 C.B. 186.

While the effective date of the regulations under section 6501(c)(9) and the publication date of the revenue procedure make them inapplicable in this case, the principles upon which they are based are implicit in section 6501(c)(9) itself. The statute requires that information about the nature and amount of the gift must be included on the return (or statement attached thereto). The regulations under section 6019 illustrate the type of information a gift tax return should contain. First, the gift tax return must contain “the fair market value of all gifts not made in money.” Treas. Reg. § 25.6019-3(a). In addition, “[t]he instructions printed on the return should be carefully followed.” *Id.* Further, the gifts made during the calendar year “must be listed on the return and described in a manner that they may be readily identified.” Treas. Reg. § 25.6019-4. See also Instructions to Form 709, p. 5 (“Describe each gift in enough detail so that the property can be easily identified.”) While there are no examples in the Treasury regulations or the Instructions to Form 709 pertaining to ownership interests in a limited liability company, we believe information similar to that required for a gift of stock should be contained on the gift tax return. In this regard, the gift tax regulations provide the following:

Description of stocks shall include number of shares, whether common or preferred, and, if preferred, what issue thereof, par value, quotation at which returned, exact name of corporation, and, if the stock is unlisted, the location of the principal business office, the State in which incorporated and the date of incorporation, or if the stock is listed, the principal exchange upon which sold.

Treas. Reg. § 25.6019-4.

Analogizing the requirements for a gift of stock to a gift of an interest in a limited liability company, we conclude that the description of a gift of an interest in an LLC should include the number of units in the limited liability company, the class type, and the percentage of ownership interest that the gift represents.

In the present situation, we conclude that the Taxpayer did not include an adequate description of the gifts to the two trusts. In particular, Taxpayer did not identify the number of units in ABC LLC being transferred, the percentage of ownership interest that those units represented, or the nature of Class B interests. Taxpayer only identified the name of the limited liability company, the purported value and the fact that the units were Class B units. This information did not allow the Commissioner to make a reasonably informed decision whether to select the return for audit. Nor do we believe that Taxpayer may legitimately argue that the absence of detailed information on the return should itself have given the Commissioner a “clue” to look for the missing information. We believe that in enacting section 6501(c)(9),

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Congress intended that taxpayers should fully disclose the nature of their gifts on the return or attachments thereto—not simply leave a trail of questions for the Commissioner to pursue. Therefore, we conclude that Taxpayer did not adequately disclose the nature of the gifts. Consequently, the period of limitations on assessment with respect to Taxpayer’s gift tax return remains open.

Turning now to whether section 6501(e)(2) applies in this case, we note that the total amount of gifts stated on Taxpayer’s return was \$200,000. In order to apply the 6-year period of limitations on assessment to Taxpayer’s return, the Service must prove that items properly includible in total gifts for that calendar year in excess of \$50,000 were omitted. Taxpayer’s gift tax return discloses Class B units in a limited liability company. The fair market value of the Class B units at the time the gifts were made was \$14 million. In accordance with section 2503, those gifts were subject to gift tax. Because the fair market value of the Class B units is in excess of 25% of the total gifts stated on Taxpayer’s return, we conclude that there has been a substantial omission of items within the meaning of section 6501(e)(2). As discussed above, Taxpayer did not adequately disclose the nature and amount of the omitted items. Therefore, the tax due on the transfers can be assessed at any time on or before October 9, 2004.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS



To the extent the transfers of interests in ABC LLC were subject to special valuation, Taxpayer did not adequately disclose the transfers in accordance with Treas. Reg. § 301.6501(c)-1(e)(2).

Although not raised in your request for advice, we note that the same analysis that applies to the Taxpayer with regard to the exceptions to the usual period of limitations on assessment also applies to Taxpayer’s Wife who agreed to split the gifts pursuant to section 2513.

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney-client privilege. If disclosure becomes necessary, please contact this office for our views.

If you have questions, please contact (202) 622-4940.

CURT G. WILSON
Administrative Provisions & Judicial

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