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# FALL UPDATE FOR ACCOUNTANTS & FINANCIAL PLANNERS

09/30/2025

presented by

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# Choice of Entity in Light of Changes to IRC 1202

**Mark W. Schweighofer**



# LIMITED LIABILITY (WITH NARROW EXCEPTIONS)

Sole  
Proprietorship

No

Single Owner  
Limited Liability  
Company

Yes

Multi-Owner  
Limited Liability  
Company

Yes

Limited  
Partnership

Yes except for general partners

S Corporation

Yes

C Corporation

Yes



# NUMBER AND TYPES OF OWNERS

Sole  
Proprietorship

One individual

---

Single Owner  
Limited Liability  
Company

One owner of any type

---

Multi-Owner  
Limited Liability  
Company

Two or more owners of any type

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S Corporation

1-100 owners, generally restricted to certain individuals, disregarded entities and certain trusts

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C Corporation

No restriction

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# EASE IN CHANGING ENTITY

Sole Proprietorship	Yes
Single Owner Limited Liability Company	Yes
Multi-Owner Limited Liability Company	Yes, but can have unintended consequences and watch for negative capital accounts
S Corporation	Yes, to a C corporation
C Corporation	Only easy to become S corporation but will face double tax for at least 5 years

Watch for cash basis C corporations electing S treatment



# GAIN ON PROPERTY DISTRIBUTIONS

Sole Proprietorship

No

Single Owner Limited  
Liability Company

No

Multi-Owner Limited  
Liability Company

Usually No

S Corporation

Yes

C Corporation

Yes



# CHARACTER OF GAIN ON SALE OF COMPANY<sup>7</sup> (SALE OF OWNERSHIP INTERESTS)

Sole Proprietorship      Mix

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Single Owner Limited  
Liability Company      Mix

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Multi-Owner Limited  
Liability Company      Mix

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S Corporation      Capital, absent a 338(h)(10) election; F-Reorg or similar

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C Corporation      Capital

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# CHARACTER OF GAIN ON SALE OF COMPANY (ASSET SALE)

Sole Proprietorship

**Mix**

Single Owner Limited Liability Company

**Mix**

Multi-Owner Limited Liability Company

**Mix**

S Corporation

**Mix**

C Corporation

**Capital, but subject to double taxation**



# 3.8% TAX ON NET INVESTMENT INCOME

Sole Proprietorship

No, if materially participate

---

Single Owner Limited  
Liability Company

No, if materially participate

---

Multi-Owner Limited  
Liability Company

No, if materially participate

---

S Corporation

No, if materially participate

---

C Corporation

Yes

---



# QBID DEDUCTION

Sole Proprietorship

Yes, if qualified trade or business

---

Single Owner Limited  
Liability Company

Yes, if qualified trade or business

---

Multi-Owner Limited  
Liability Company

Yes, if qualified trade or business

---

S Corporation

Yes, if qualified trade or business

---

C Corporation

No

---



# EXCLUSION ON “SMALL BUSINESS STOCK” SALE

11

Sole  
Proprietorship

No

Single Owner  
Limited Liability  
Company

No

Multi-Owner  
Limited Liability  
Company

No

S Corporation

No

C Corporation

Yes



# BASICS REQUIREMENTS FOR SECTION 1202 STOCK

- Stock must be original issuance from a domestic C corporation after August 10, 1993 acquired in exchange for money or nonstock property or as compensation for services.
- Corporation must be a qualified small business with assets under \$ 50 million historically (modified by OBBB).
- Historically, stock must be held for more than five years to qualify for exclusion (modified by OBBB).
- At least 80% of corporation's assets must be used in an active business.
- Certain service businesses are excluded from Section 1202 benefits.



# SERVICE BUSINESSES EXCLUDED FROM SECTION 1202 BENEFITS

- Health care providers, including doctors and dentists, are excluded.
- Law firms and accounting practices do not qualify.
- Financial services, such as banking and insurance companies, are excluded.
- Consulting firms providing professional advice are not eligible.
- Performing arts businesses, including artists and entertainers, are excluded.
- Brokerage businesses engaged in buying and selling are disqualified.



# SECTION 1202 STOCK BENEFITS

- Historically, assuming all requirements satisfied ,QSBS issued:
  - after 1993 and prior to 2009--allowed exclusion is 50%.
  - between 2009 and 2010—allowed exclusion is 75%, and
  - after 2010 but prior to July 4, 2025, the exclusion is 100%.
  - This exclusion was historically limited to the greater of \$10 million or 10 times the taxpayer's adjusted basis in their stock.
- Note, QSBS treatment can still produce savings even if structured as an asset sale if followed by liquidation



# KEY ENHANCEMENTS TO SECTION 1202 FROM OBBB ACT

- Reduced holding period for stock acquired on or after July 4, 2025:
  - 50% exclusion for stock held for at least three years;
  - 75% exclusion for stock held for at least four years; and
  - 100% exclusion for stock held for at least five years
    - Note, higher capital gain rate (28%) for included gain for stock held for the 50% and 75% thresholds



# KEY ENHANCEMENTS TO SECTION 1202 FROM OBBB ACT

- Increased Cap—now \$15M (rather than \$10)
  - Note—10X basis limitation remains the same
- Increased asset threshold--\$75M up from \$50M



# SECTION 1202

- STRATEGIES FOR NON-C CORPORATIONS TO UTILIZE SECTION 1202
  - For single member LLC's or LLC's taxed as partnership:
    - Convert from an LLC to a corporation using a state conversion statute or a merger (varies by jurisdiction)
    - File a form 8832 to elect to be taxed as a corporation (assuming no prior election in the prior 60 months)
  - NOTE: Section 1202 holding period will *not* commence unless conversion takes place

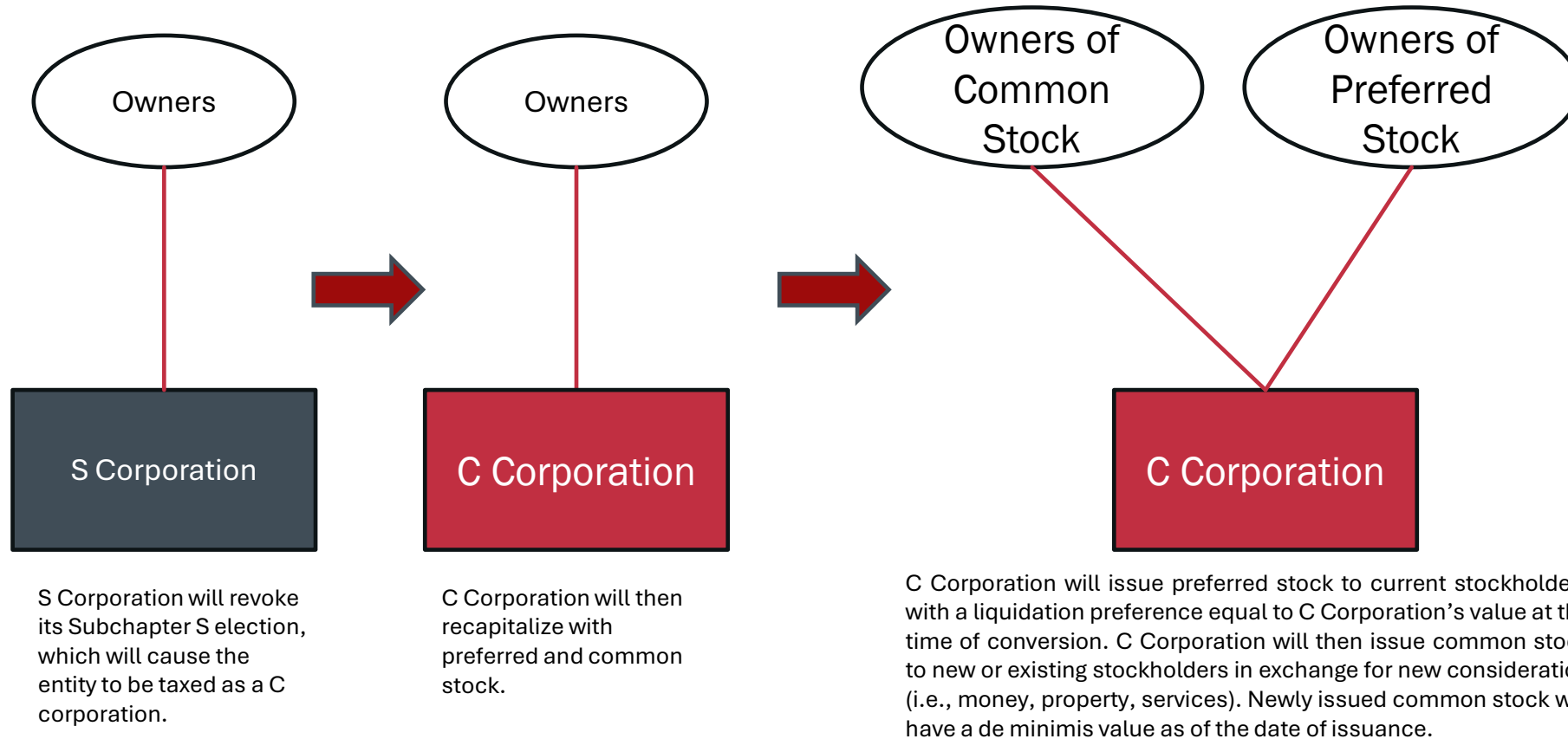


# SECTION 1202

- For S-Corporations
  - Revocation and Recapitalization
  - F Reorg with C corp. intermediary



## Revocation and Recapitalization

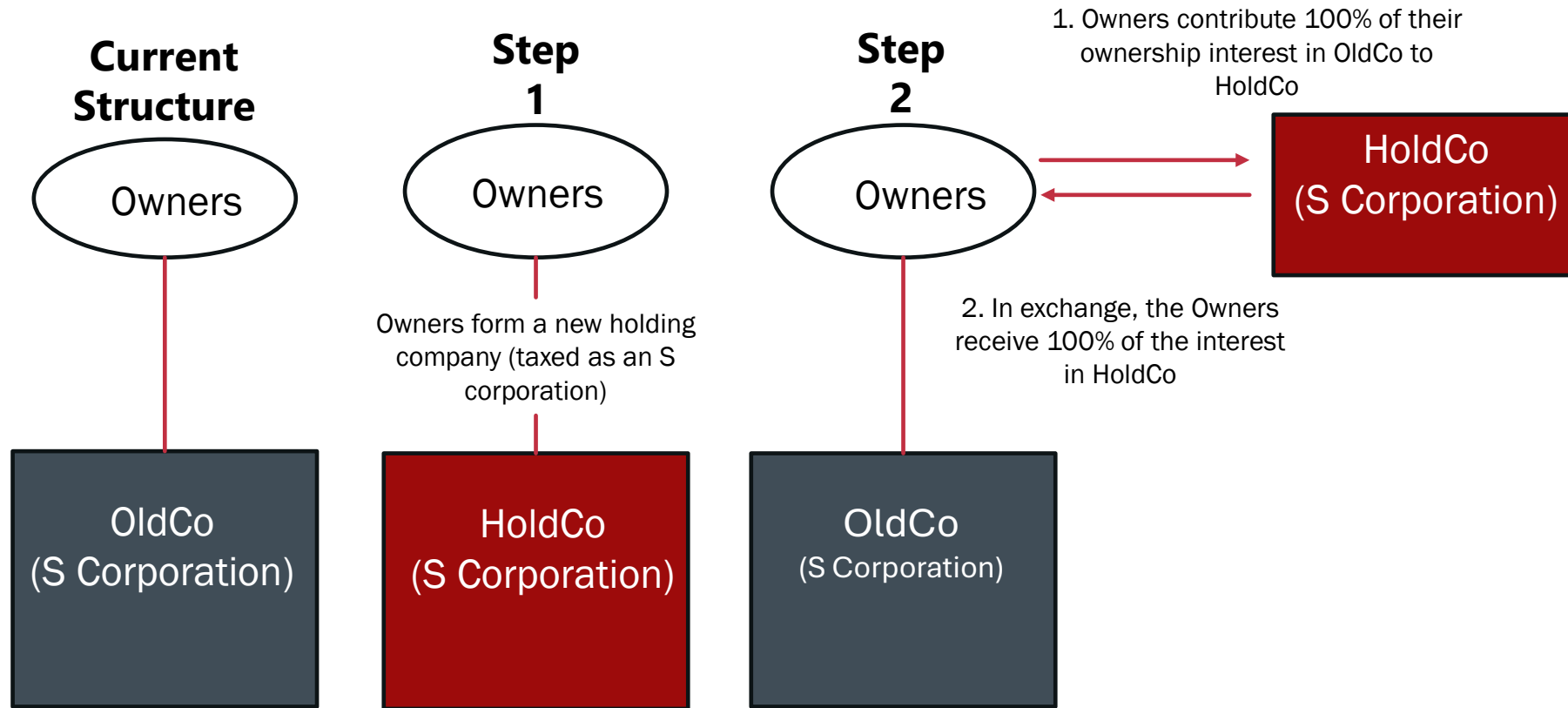


# SECTION 1202

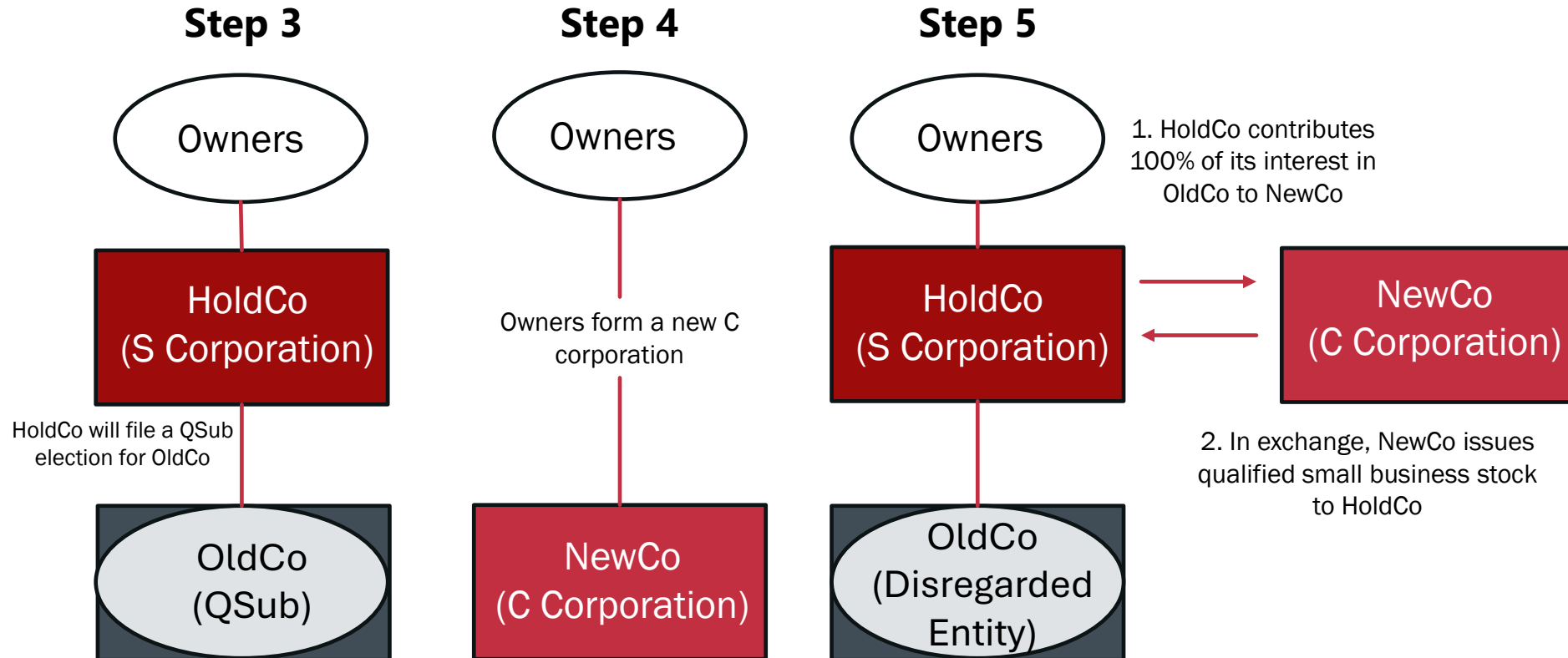
- Revocation and Recapitalization
  - Newly issued preferred stock would not qualify as QSBS, so any existing value of the entity at time of would not be eligible and would be taxed at capital gains rates



## F Reorganization and Contribution

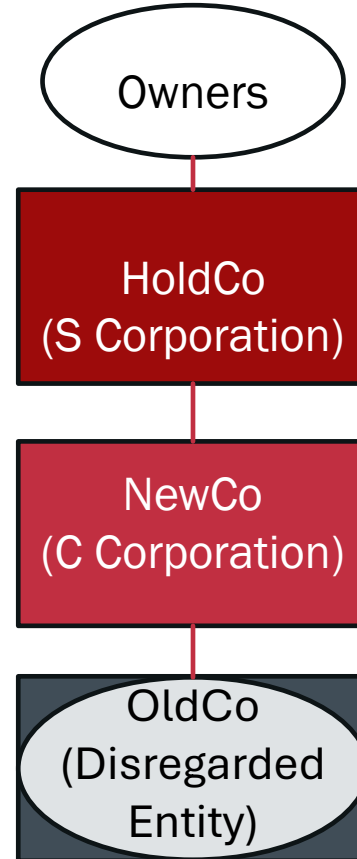


## F Reorganization and Contribution



## F Reorganization and Contribution

### Final Structure



# SECTION 1202

- F reorg
  - Immediately following step 3 (post-QSUB election), the entity would either file a form 8832 to be treated as a disregarded entity (if the original S corporation was an LLC for state law purposes) or convert from a corporation to a SMLLC under a state law conversion or merger statute



# SECTION 1202

- F reorg
  - A significant benefit of this approach is that when HoldCo contributes its interest in the OldCo to NewCo C corporation, the fair market value of the OldCo interests become HoldCo's basis in NewCo C corporation. This can substantially enhance the Section 1202 exclusion because 10X basis may be greater than the \$15M exclusion



# GOVERNING DOCUMENTS

Sole  
Proprietorship

None

Single Owner  
Limited Liability  
Company

Becoming increasingly required

Multi-Owner  
Limited Liability  
Company

Need operating agreement, use caution of S election is made

S Corporation

Should prepare stockholder agreement

C Corporation

Should prepare stockholder agreement



# COMPENSATING EMPLOYEES WITH EQUITY INTERESTS

Sole  
Proprietorship

No

Single Owner  
Limited Liability  
Company

No

Multi-Owner  
Limited Liability  
Company

Generally easy through interest in profits only

S Corporation

Challenging

C Corporation

Generally easy through multiple classes of stock



# SINGLE LEVEL OF TAXATION

Sole Proprietorship	Yes
Single Owner Limited Liability Company	Yes
Multi-Owner Limited Liability Company	Yes
S Corporation	Yes, possible tax at corporate level if C corporation in prior 5 years
C Corporation	No



# MINIMIZE PAYROLL TAXES

Sole Proprietorship	No
Single Owner Limited Liability Company	No, if individual
Multi-Owner Limited Liability Company	No, if individual is akin to general partner
S Corporation	Yes, subject to reasonable salary requirement
C Corporation	No



# OUTSIDE BASIS IN ENTITY INTEREST

Sole  
Proprietorship

N/A

Single Owner  
Limited Liability  
Company

N/A

Multi-Owner  
Limited Liability  
Company

Generally includes share of all entity debt, subject to allocation regulations and at-risk rules

S Corporation

Includes certain loans in limited instances but not guarantees

C Corporation

Does not directly include loans





# Estate Planning with the Certainty of OBBBA

*David B. Torchinsky*





# OVERVIEW

- A. Overview of federal and state estate tax exemptions
- B. Strategic estate planning and long-term wealth transfer planning via credit shelter/bypass trusts
- C. Making the portability election





# FEDERAL & STATE ESTATE TAX EXEMPTIONS



# FEDERAL ESTATE TAX

- The federal estate tax is a tax imposed on the value of all property owned by a decedent as of the date of his/her death.
  - Reflects a snapshot of the gross value of the everything owned by a decedent as of the date of death.
  - Gross Estate
    - Gross Estate includes all property in which the decedent had an interest (including property outside the United States)
    - Fair market value is used, and all items are included (e.g., cash and securities, real estate, insurance, trusts, annuities, business interests, etc.)
      - Real estate requires appraisals valued as of the date of death to establish basis.
      - Life insurance requires IRS Form 712 to capture the value of the death proceeds of a policy.
      - Retirement accounts and other brokerage accounts/portfolios assets must be valued as of date of death.



# FEDERAL ESTATE TAX

- Taxable Estate
  - Taxable Estate is the gross estate minus deductions such as mortgage, debts, estate administration expenses, and property passing to surviving spouses and qualified charities.
  - Gifts
    - Value of lifetime taxable gifts are also added to the taxable estate.
    - Current annual exclusion for gifts made in 2025 is \$19,000.



# CAPITAL GAINS

- Capital gains become taxable upon the sale or exchange of an asset.
- Key aspect of estate planning is the incorporation of the step up in basis rule to value a decedent's assets
  - § 1014 Basis of Property Acquired from a Decedent
    - Permits decedent's property be valued as of the fair market value of the property as of the date of the decedent's death, thereby avoiding capital gains tax, thereby avoiding capital gains tax



# CAPITAL GAINS

- Capital Gains Rates

- For 2025, a capital gains rate of 15% applies if taxable income is:
  - between \$47,025 and \$518,900 for single filers;
  - between \$47,025 and \$291,850 for married filing separately;
  - between \$94,050 for \$583,750 for married filing jointly and qualifying surviving spouse; and
  - between \$63,000 and \$551,350 for head of household.
- A capital gains rate of 20% applies for taxable income that exceeds the thresholds set for the 15% capital gains rate



# CAPITAL GAINS

- Capital Gains Rates (cont.)
  - In 2026 , the capital gains rate will remain at 15% but the rates are projected to adjust to impose capital gains if taxable income is:
    - between \$49,450 and \$545,500 for single filers;
    - between \$98,900 and \$613,700 for married filing jointly and for surviving spouses;
    - between \$49,500 and \$306,850 married filing separately;
    - between \$66,200 and \$579,600 for head of household; and
    - between \$3,300 and \$16,250 for trusts and estates.



# TAX TREATMENT OF GRANTOR TRUSTS VS. NON-GRANTOR TRUSTS

- Grantor Trusts - grantor reports all income, deductions and credits are reported on the grantor's personal 1040
- Non-Grantor Trusts – treated as a separate taxpayer and must file its own Form 1041
  - Beneficiaries may also pay income tax on distributions



# TAX TREATMENT OF GRANTOR TRUSTS VS. NON-GRANTOR TRUSTS

- Under the Tax Cuts and Jobs Act (TCJA), Non-Grantor Trusts are able to attribute a deduction of \$40,000 on its taxable income
  - Grantor Trusts do not receive this deduction because the grantor is already granted the standard deduction as an individual
  - Non-Grantor Trusts are essentially treated in the same manner as individuals in that they can obtain certain deductions: See IRC § 67(e) Determination of adjusted gross income in case of estates and trusts:

For purposes of this section, the adjusted gross income of an estate or trust shall be computed in the same manner as in the case of an individual, except that—

- the deductions for costs which are paid or incurred in connection with the administration of the estate or trust and which would not have been incurred if the property were not held in such trust or estate, and
- the deductions allowable under sections 642(b), 651, and 661, shall be treated as allowable in arriving at adjusted gross income. Under regulations, appropriate adjustments shall be made in the application of part I of subchapter J of this chapter to take into account the provisions of this section.





# IRS FORM 706 U.S. ESTATE (AND GENERAL-SKIPPING TRANSFER) TAX RETURN (NEWLY REVISED AS OF AUGUST 2025)

Filed by the executor/personal representative of the estate for:

- Decedents whose gross estate + adjusted taxable gifts and specific exemptions are greater than \$13,990,000; OR
- Executors electing to transfer the deceased spousal unused exclusion (DSUE) amount to the surviving spouse, regardless of the size of the decedent's gross estate.



# IRS FORM 706 U.S. ESTATE (AND GENERAL-SKIPPING TRANSFER) TAX RETURN (NEWLY REVISED AS OF AUGUST 2025)

Form **706** **United States Estate (and Generation-Skipping Transfer) Tax Return**  
 (Rev. August 2025) Estate of a citizen or resident of the United States (see instructions). To be filed for decedents dying after December 31, 2024. OMB No. 1545-0015  
 Department of the Treasury Go to [www.irs.gov/Form706](http://www.irs.gov/Form706) for instructions and the latest information.  
 Internal Revenue Service

**Part I Decedent and Executor (see instructions)**

1a Decedent's first name and middle initial (and maiden name, if any)		1b Decedent's last name		2 Decedent's social security no.	
3a City, town, or post office. For foreign addresses, also complete lines 3e, 3f, and 3g.			3b County	3c State	3d ZIP code
3e Foreign country name	3f Foreign province/state/county	3g Foreign postal code	4 Year domicile established	5 Date of birth	6 Date of death
7a Name of executor				7b Executor's TIN	
7c Executor's address (number and street)				7d Apt. or suite no.	
7e City, town, or post office. For foreign addresses, also complete lines 7h, 7i, and 7j.				7f State	7g ZIP code
7h Foreign country name	7i Foreign province/state/county	7j Foreign postal code	7k Executor's phone no.		
7l <input type="checkbox"/> Check here if there are multiple executors. If checked, attach a list with the names, addresses, telephone numbers, and SSNs of the additional executors.					
8a Name of court where will was probated or estate administered		8b Location of court where will was probated or estate administered		8c Case number	

**Check all that apply**

9a  The decedent died testate.  
 b  You attached a certified copy of the Will.  
 10  You attached the death certificate. **Note.** A death certificate must be attached.  
 11  You extended the time to file this Form 706.  
 12  You are estimating the value of assets included in the gross estate on Part II, line 1 pursuant to the special rule of Reg. section 20.2010-2(a)(7)(i).  
 13  This is a supplemental return.  
 14a  You previously filed a section 2053 protective claim for refund that is now ready for consideration.  
 b If line 14a is checked, enter the filing date(s) of the initial section 2053 protective claim(s) for refund:

**Part II Tax Computation (see instructions)**

1	Total gross estate less exclusion from Part V, item 13	1
2	Tentative total allowable deductions from Part V, item 24	2
3a	Tentative taxable estate. Subtract line 2 from line 1	3a
b	State death tax deduction	3b
c	Taxable estate. Subtract line 3b from line 3a	3c
4	Adjusted taxable gifts. See instructions	4
5	Add lines 3c and 4	5
6	Tentative tax on the amount on line 5 from Table A in the instructions	6
7	Total gift tax paid or payable. See instructions	7
8	Gross estate tax. Subtract line 7 from line 6	8
9a	Basic exclusion amount	9a
b	Deceased spousal unused exclusion (DSUE) amount from predeceased spouse(s), if any, from Part VI, Section D, line 4	9b
c	Restored exclusion amount. See instructions	9c
d	Applicable exclusion amount. Add lines 9a, 9b, and 9c	9d
e	Applicable credit amount. Tentative tax on the amount on line 9d from Table A in the instructions	9e
10	Adjustment to applicable credit amount. Do not enter more than \$6,000. See instructions	10
11	Allowable applicable credit amount. Subtract line 10 from line 9e	11
12	Subtract line 11 from line 8. If zero or less, enter -0-	12

For Privacy Act and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 20548R Form **706** (Rev. 8-2025) Created 5/30/25





# IRS FORM 706

- When to file
  - IRS Form 706 must be filed within nine (9) months of date of death.
  - IRS Form 4768 may be filed to apply for an automatic six (6) month extension of time to file the federal estate tax return.
- Filing Threshold
  - Estates valued in excess of the exemption can be taxed up to 40%.
  - Historically, the estate tax threshold has been increasing steadily as they are adjusted for inflation each year. *See* 26 U.S.C. § 2010(c)(3).



# FEDERAL ESTATE TAX

## Federal Estate Tax Threshold

Year of Death	Exemption Threshold (single filers)	Exemption Threshold (married filing jointly filers)
2023	\$ 12,920,000.00	\$25,840,000
2024	\$ 13,610,000.00	\$27,220,000
2025	Current: \$ 13,990,000.00	\$27,980,000
2026	Under OBBBA: \$ 15,000,000.00	\$30,000,000
2027-Indexed	\$ 15,000,000.00	\$30,000,000



# FEDERAL ESTATE TAX

- Filing Threshold (cont.)
  - Under current law, the estate and lifetime gift tax exemption amount were set to expire on December 31, 2025, and revert to \$5,000,000-Indexed.
  - Under the One Big Beautiful Bill Act<sup>1</sup>, Congress permanently extended estate and lifetime gift tax exemption and increased the exemption amount to \$15,000,000 for single filing (\$30,000,000 for married filing jointly) for decedents dying and gifts made after December 31, 2025.
    - This will be the permanent exemption threshold (unless Congress changes it).

<sup>1</sup>Text - H.R.1 - 119th Congress (2025-2026): One Big Beautiful Bill Act, H.R.1, 119th Cong. (2025), <https://www.congress.gov/bill/119th-congress/house-bill/1/text>.





**OBBA offers certainty in that the GST exemption no longer comes with an expiration date.<sup>2</sup>**

<sup>2</sup> Kaufman, Beth Shapiro. One Big Beautiful Bill, Capital Letters, American College of Trust and Estate Counsel. <https://www.actec.org/capital-letter/one-big-beautiful-bill-commentary/>



# STATE ESTATE TAX

- Some states also impose additional estate taxes and inheritance taxes.
  - D.C. imposes estate taxes.
  - Virginia does not levy estate taxes.
  - Maryland is only state that levies *both* estate and inheritance taxes.



# MARYLAND ESTATE & INHERITANCE TAX

- Maryland estate tax is a transfer tax imposed on transfer of assets from an estate.

## Maryland Estate Tax Threshold

Year of Death	Exemption Threshold (Single filers)	Exemption Threshold (Married filing jointly filers)
2015	\$1,500,000.00	\$3,000,000
2016	\$2,000,000.00	\$4,000,000
2017	\$3,000,000.00	\$6,000,000
2018	\$4,000,000.00	\$8,000,000
2019 and beyond*	\$5,000,000.00	\$10,000,000

\*Maryland estate tax threshold not indexed for inflation. It will remain at \$5,000,000 unless further legislation is passed.



# MARYLAND ESTATE & INHERITANCE TAX

- Threshold for estate tax exclusion is \$5,000,000 and is not indexed for inflation. The rate of the estate tax may not exceed 16%. *See MD Code, Tax - General, § 7-309(b)(3)(i).*
- Maryland estate tax is filed via Form MET-1, Maryland Estate Tax Return with IRS Form 706 included as an attachment.



# MARYLAND ESTATE & INHERITANCE TAX

- Maryland inheritance tax is imposed at 10% of the “clear value” of property received from a decedent. *See* MD Code, Tax – General §7-204.
  - Exemptions from inheritance tax:
    - Certain individuals/entities are not subject to inheritance tax – see MD Code, Tax – General § 7-203:
      - Surviving spouse
      - Direct or lineal heirs (e.g., grandparents, parents, children, grandchildren, siblings), and
      - 501(c)(3) tax-exempt organizations
    - Certain property is also exempt from inheritance tax. *See* MD Code, Tax – General § 7-203 (f), (g), and (h).



# D.C. ESTATE TAX

- DC exemption threshold is adjusted each year for inflation.

D.C. Estate Tax Threshold	
Year of Death	Exemption Threshold
2023	\$4,528,800
2024	\$4,715,600
2025	\$4,873,200



# D.C. ESTATE TAX

- Unlike federal and Maryland, D.C. exemption is not portable between spouses.
- D.C. Estate Tax Return Form D-76 is also filed with Form 706 included as an attachment.
- Form D-76 must be filed for decedent's gross estate, even if a federal estate tax return is not required to be filed.
- D.C. Estate Tax Return must be filed and tax paid within ten (10) months after the decedent's date of death.
- Form D-76 for deaths occurring in 2017 or later must be filed and paid electronically via [MyTax.DC.gov](https://mytax.dc.gov).





# **STRATEGIC ESTATE PLANNING AND LONG-TERM WEALTH TRANSFER PLANNING**



# FORCED CREDIT SHELTER/BYPASS TRUST

- For transfers of property between spouses, spouses may take an unlimited marital deduction for full amount of the transfer; all transfers of assets between spouses are tax-free.
- Credit Shelter Trusts are designed to allow married couples to avoid estate taxes on transfers of property upon the death of the predeceasing spouse.
  - Disclaimer is a technique which allows a surviving spouse to disclaim some or all of the predeceasing spouse's inherited assets in order to maximize the predeceasing spouse's federal and state estate tax exemptions, thereby reducing the surviving spouse's potential estate tax liability at his/her later death.
  - Assets which are disclaimed, can be redirected to one or more "disclaimer trusts" created for the benefit of the surviving spouse.



# FORCED CREDIT SHELTER/BYPASS TRUST

- Credit Shelter Trusts (cont.)
  - *Advantages*
    - Good for blended families to ensure the assets eventually will pass to the specific family.
    - Moves the asset out of the estate of the surviving spouse.
    - The appreciation is out of the estate of the surviving spouse.
    - Creditor protection in an irrevocable Trust
    - Provides flexibility for the surviving spouse to determine whether or not to disclaim.
  - *Disadvantages*
    - No step up in basis on the second death
    - Ongoing administration responsibilities – trust accounting, tax filings, and trustee oversight
  - Other Issues
    - Credit Shelter Trusts holding a residence.
      - No step-up at second death and no Section 121 exclusion





# PORTABILITY OF THE DECEASED SPOUSAL UNUSED EXCLUSION (DSUE)





# PORTABILITY OF UNUSED EXEMPTION

- A surviving spouse has the option to utilize any remaining federal estate tax exemption upon his/her death if the election is made on the predeceasing spouse's estate tax return.
- Under OBBBA, surviving spouse may utilize up to \$30,000,000 of a combined federal estate tax exemption at his/her death.





# ELECTING PORTABILITY

- Form 706 must be filed within nine (9) months of the predeceasing spouse's death, or within fifteen (15) months if application for automatic six (6) month extension is filed.
  - Executors who failed to timely file may make the portability election on or before fifth anniversary of the decedent's death. *See Rev. Proc. 2022-32, 2022-30 I.R.B. 101.*



# ELECTING PORTABILITY

- Advantages
  - Unused exemption is passed to the surviving spouse outright.
  - Second to die spouse receives second step up in basis—especially important for more income tax planning.
  - Ease of dealing with the administration
  - Form 1041s not required on an annual basis except those that may be required to administer the final affairs of the decedent.
  - Can make the election within five (5) years of the date of death if the Federal and Maryland returns were not required for the decedent.



# ELECTING PORTABILITY

- Disadvantages
  - Not automatic
  - Return must be filed in detail.
  - Goes to the surviving spouse outright.
  - Surviving spouse can redirect the estate plan and give the estate to whomever they wish.
  - No creditor protection
  - The ultimate loss of control by the decedent
  - GST exemption is not portable; it is permanently lost here.
    - Can only be made at the death of the predeceasing spouse and must be filed correctly in order to be effective.



# IMPORTANCE OF FILING A TIMELY & PRECISE 706

*Cautionary Tale of the Estate of Billy S. Rowland, James A. Park, Executor, Petitioner v. Commissioner of Internal Revenue, Respondent*<sup>3</sup>

## Facts

- Fay Rowland passed away in 2016 with a gross estate of about \$3 million.
- The executor of the Fay Rowland estate ultimately filed the estate tax return in December 2017 (6 months later than the deadline for the automatic extension)
- Fay's Estate completed Form 706 by listing various assets which Mrs. Rowland held an interest in at the time of her death, including real property, shares of Rowland Motors, Inc. and other stock, and various bank accounts.
- \**"The return did not include any information as to fair market value of those assets but instead estimated the gross value of the estate."* See Rowland, at \*2.

<sup>3</sup>Est. of Rowland v. Commissioner of Internal Revenue, 2025 WL 2078422, at \*2 (U.S. Tax Ct., 2025)



# IMPORTANCE OF FILING A TIMELY & PRECISE 706

*Cautionary Tale of the Estate of Billy S. Rowland, James A. Park, Executor, Petitioner v. Commissioner of Internal Revenue, Respondent*<sup>3</sup>

## Facts (cont.)

- The IRS ultimately received the Fay Rowland Estate's 706 on January 2, 2018
- Billy Rowland passed away in late January 2018
- Billy Rowland's estate timely filed the 706 reporting an adjusted taxable DSUE from Fay's estate of about \$3.7 million.
- The IRS selected Billy's return for examination and ultimately issued a notice of deficiency, determining that Billy's estate was ineligible to claim the DSUE.
  - "Upon review of [Fay's Return], a properly, complete, and effective portability election was not made to port such predeceased spouse's unused applicable exclusion amount to her surviving spouse.... and, accordingly, no DSUE amount was available for [Billy's estate]." *Id.* at \*2.

<sup>3</sup>Est. of Rowland v. Commissioner of Internal Revenue, 2025 WL 2078422, at \*2 (U.S. Tax Ct., 2025)



# IMPORTANCE OF FILING A TIMELY & PRECISE 706

*Cautionary Tale of the Estate of Billy S. Rowland, James A. Park, Executor, Petitioner v. Commissioner of Internal Revenue, Respondent*<sup>3</sup>

## Discussion

- § 2010(c)(5)(A) provides that the DSUE cannot be taken unless the surviving spouse files the estate tax return and files *timely*.
  - “A deceased spousal unused exclusion amount may not be taken into account by a surviving spouse under paragraph (2) unless the executor of the estate of the deceased spouse files an estate tax return on which such amount is computed and makes an election on such return that such amount may be so taken into account. Such election, once made, shall be irrevocable. No election may be made under this subparagraph if such return is filed after the time prescribed by law (including extensions) for filing such return.”
  - Fay’s estate failed to make a timely election:
    - Fay died on April 8, 2016. Accordingly, the estate tax return would be due nine (9) months later, January 8, 2017.
    - Fay’s executors applied and received an automatic extension, moving the due date to July 8, 2017, but did not file the return until December 29, 2017. The IRS did not receive it until January 2, 2018.
  - Although Rev. Proc. 2017-34, provides a safe harbor that permits the return be filed on or before the second annual anniversary of the decedent’s date of death, the return still failed for lack of precision.

<sup>3</sup>Est. of Rowland v. Commissioner of Internal Revenue, 2025 WL 2078422, at \*2 (U.S. Tax Ct., 2025)



# IMPORTANCE OF FILING A TIMELY & PRECISE 706

*Cautionary Tale of the Estate of Billy S. Rowland, James A. Park, Executor, Petitioner v. Commissioner of Internal Revenue, Respondent*<sup>3</sup>

## Discussion (cont.)

- § 20.2010-2(a)(2) requires that an election for portability be complete and properly prepared
  - “(2) Portability election upon filing of estate tax return. Upon the *timely filing* of a complete and properly prepared estate tax return, an executor of an estate of a decedent survived by a spouse will have elected portability of the decedent's DSUE amount unless the executor chooses not to elect portability and satisfies the requirement in paragraph (a)(3)(i) of this section. See paragraph (a)(7) of this section for the return requirements related to the portability election.”
  - Fay's Return did not provide valuation information regarding each of the interest in property reported on the various schedules.
    - Although § 20.2010-2(a)(7) relaxes reporting requirements for certain property (for marital property and charitable deduction property), Fay's Return failed to make any distinction between such property and the rest of property interests reported.
    - The Court noted that Fay's Return incorrectly applied the relaxed treatment of reporting requirements across the board for all property interests in all schedules.

<sup>3</sup>Est. of Rowland v. Commissioner of Internal Revenue, 2025 WL 2078422, at \*2 (U.S. Tax Ct., 2025)



# IMPORTANCE OF FILING A TIMELY & PRECISE 706

*Cautionary Tale of the Estate of Billy S. Rowland, James A. Park, Executor, Petitioner v. Commissioner of Internal Revenue, Respondent*<sup>3</sup>

- Conclusion

- “In summary, Fay’s Return was not entitled to estimate the gross value of Fay’s Estate but instead was required to provide specific valuation information for each property interest listed in the schedules. Fay’s Return thus did not constitute a complete and properly prepared return eligible for the Rev. Proc. 2017-34 safe harbor.” *Id.* at \*6.

<sup>3</sup>Est. of Rowland v. Commissioner of Internal Revenue, 2025 WL 2078422, at \*2 (U.S. Tax Ct., 2025)



# IRS DISCRETION TO GRANT EXTENSION TO FILE 706

## Private Letter Rulings

- PLR 202536001 and 202536002, released Sept. 5, 2025
  - Information, affidavits, and representations submitted on behalf of Decedent's estate explained circumstances that resulted in the failure to timely file a valid election.
  - Per § 301.9100-1(c) and § 301.9100-3, the Commissioner has discretion to grant reasonable extension when taxpayer provides evidence to establish that the taxpayer acted reasonably and in good faith and that granting relief will not prejudice the government.



# IRS DISCRETION TO GRANT EXTENSION TO FILE 706

## Rev. Proc. 2022-32 5-Year Safe Harbor to File for Portability Only

- Pursuant to IRS Rev. Proc. 2022-32, an additional safe harbor for surviving spouses wish to file the estate tax return to elect portability.
  - Rev. Proc. 2017-34 permits an executor to make the portability election within 5 years of the decedent's date of death where the estate was not required to file an estate tax return.
  - The executor must file a complete and properly prepared 706 and must state at the top of the Form 706 that the return is "FILED PURSUANT TO REV. PROC. 2022-32 TO ELECT PORTABILITY UNDER § 2010(c)(5)(A). See Rev. Proc. 2022-32, Section 4.01(2), Relief for Certain Late Portability Elections



# PORTABILITY FOR STATE ESTATE TAXES

- D.C. does not permit portability election; Virginia has no estate tax.
- Maryland permits portability for spouses. Couples can have a combined \$10,000,000 exemption before owing any Maryland estate taxes at the death of the surviving spouse.
  - In January 2025, MD HB1014, aka the Fair Share for Maryland Act of 2025, proposed, in part, reducing the estate tax exemption from \$5 million to \$2 million for decedents dying on or after January 1, 2026. The bill was never passed.
- Making the Election on Form MET-1
  - Must complete Schedule F, Part I of the Maryland Return
    - Must input an amount in Line 3 AND check box.



# MAKING THE PORTABILITY ELECTION ON FORM MET-1

Form MET 1  
Schedule F  
Rev. 06/23

**Decedent information:**

John	M.	Doe	123-45-6789
First name	Middle name	Last name	Social Security number

SCHEDULE F

Use this schedule to elect portability of the Deceased Spousal Unused Exclusion (DSUE) if the decedent died on or after January 1, 2019.

**PART I - To be completed by the estate of a decedent making a portability election. This is the amount claimed to be passed to the surviving spouse.**

- |  |    |    |              |
|--|----|----|--------------|
| 1. Exclusion amount for decedent passing after December 31, 2018. . . . .  | 1. | \$ | 5,000,000.00 |
| 2. Enter the amount from Section IV, Line 7 of the MET-1 here. . . . .   | 2. | \$ | 0.00         |
| 3. Deceased Spousal Unused Exclusion Amount: Subtract Line 2 from Line 1.<br>This is the DSUE amount portable to the surviving spouse. To elect portability of the<br>deceased spouse unused exclusion amount, check here. . . . . | 3. | \$ | 5,000,000.00 |

**PART II - To be completed by the deceased surviving spouse claiming an unused exclusion amount on this MET-1.**

Enter the name of the predeceased spouse: \_\_\_\_\_

Enter Social security number of the predeceased spouse: \_\_\_\_\_

- |  |    |    |       |
|--|----|----|-------|
| 1. Maryland exclusion amount at time of death for the predeceased spouse. . . . .  | 1. | \$ | _____ |
| 2. Enter the tentative taxable estate amount for predeceased spouse.<br>(MET-1 Section IV, Line 7 or Federal Form 706, Line 3a). . . . . | 2. | \$ | _____ |
| 3. Subtract Line 2 from Line 1. Enter this amount on line Section IV, Line 8b. . . . .   | 3. | \$ | _____ |
| 4. Multiply Line 3 by 40% . . . . .  | 4. | \$ | _____ |



# IMPLICATIONS FOR FILING FORM 706 OTHER THAN FOR THE PURPOSE OF PORTABILITY

- When a decedent's gross estate (with taxable gifts and specific exemptions) is greater than the exemption amount and the GST Tax Return is required, Form 8971 and a copy of Schedule A are also required.
  - IRS Form 8971, Information Regarding Beneficiaries Acquiring Property from a Decedent
    - Form 8971 reports the final estate tax value of property distributed or to be distributed from the estate.
    - Schedule provides basis information to beneficiaries who acquire certain property from the decedent.
  - Form 8971 is due 30 calendar days from the due date for filing Form 706





# Civil and Criminal Tax Fraud

David De Jong



# CIVIL TAX FRAUD – PENALTY

- The 75 percent penalty applies to the portion of any tax return which is fraudulent.
  - The 20 percent accuracy may apply to the other portions of the return.
  - In a Notice of Deficiency, IRS will often assert civil fraud and then accuracy as an alternative since both cannot apply to the same “errors”.





# CIVIL TAX FRAUD – EFFECTS

- Civil tax fraud penalty is in addition to any criminal fines with no setoff.
- Unlimited statute of limitations instead of three or six years (understatement of gross income by more than 25 percent)
- Inability to bankrupt liability for tax years in which fraud penalty applies.



# CIVIL TAX FRAUD - PARTIES

- The civil fraud penalty can only be imposed against the party committing the fraud. On a joint return, it may not be imposed on a spouse not a party to the fraud (irrespective of innocent spouse status).
- However, for purpose of the unlimited statute of limitations, any fraud on the tax return (even that solely of preparer) negates an end date per an August 18, 2025 decision of the Third Circuit Court of Appeals in Murrin v. Commissioner (the Federal Circuit Court of Appeals reached an opposite result in 2015).



# CIVIL TAX FRAUD – AMENDED RETURNS

- Filing an amended return does not cure the civil fraud which computation is applied based on the original return.
- In a “voluntary disclosure” to avoid possible criminal penalties, IRS will only impose the civil fraud penalty as to the year with the greatest liability on the amended return.



# CIVIL TAX FRAUD – BURDEN/STANDARD OF PROOF

- In civil tax cases, an assessment of the Commissioner is presumed correct and the burden of proof rests with the taxpayer who can shift the burden to IRS by cooperating, having maintained proper substantiation and presenting credible evidence.
- Whichever party has the burden, the standard of proof is normally “preponderance of the evidence.”
- However, to prove civil fraud, the burden is always on IRS and the standard is “clear and convincing evidence.”





# CIVIL TAX FRAUD – DEFINITION

- Civil tax fraud is an intentional wrongdoing on the part of the taxpayer to evade a tax owing or believed to be owing.
  - Intent
  - Underpayment



# CIVIL TAX FRAUD – INTENTIONAL WRONGDOING

- Taxpayer must have intended to mislead, conceal or prevent collection of taxes (violation of a known legal duty).
- Intent includes “willfull blindness” which is a conscious avoidance of the truth to give an inference of knowledge (recklessness).
- Intent does not include carelessness.



# CIVIL TAX FRAUD – INDICIA

- Understatement of income
- Inadequate records
- Implausible/inconsistent/incredulous explanations
- Concealment of assets
- Illegal activities
- Failure to cooperate
- Dealing in cash
- Failing to file (generally only when coupled with one or more of the above)





# CIVIL TAX FRAUD – MOST LIKELY “CANDIDATES”

- The more educated the taxpayer (especially in tax or accounting), the more likely that significant errors constitute fraud.



# CIVIL FRAUD – DEFENSES

- Reasonable cause
- Careless but not willful
- Reliance on others (with complete disclosure to recipient)





# CRIMINAL FRAUD – STATISTICS

- For the fiscal year ending September 30, 2024, IRS initiated 2,667 criminal investigations – just over 50 percent of the number of investigations in peak years.
- About two-thirds of investigations lead to prosecution.
- IRS averages 90 percent success in prosecuted cases resulting in a plea or conviction.





# CRIMINAL FRAUD – RECENT AREAS OF FOCUS

- In Fiscal 2024, IRS opened 493 criminal investigations into COVID-related fraud, mostly related to Employee Retention Credit (ERC).
- In prior years, IRS opened over 700 criminal investigations that were COVID-related, most related to the Paycheck Protection Program (PPP).
- Just under 50 percent of the early PPP cases investigated have led to prosecution.



# CRIMINAL FRAUD – VOLUNTARY DISCLOSURE

- The IRS voluntary disclosure is a two-step process that can be utilized (in lieu of a “silent disclosure”) where a taxpayer knows that a return was inaccurate at the time of filing.
- Eligibility:
  - Payment of balance plus additions in full or “good faith” arrangements to pay.
  - No IRS action or awareness.



# CRIMINAL FRAUD – PROCEDURES FOR VOLUNTARY DISCLOSURE

- Preclearance by filing Part I of Form 14457
- After receipt of a “preclearance letter” completion within 45 days of Part II of Form 14457.
- IRS will assign a Revenue Agent to the case who will normally audit one year.



# CRIMINAL FRAUD – HOW DO CASES ARISE?

- Civil audit
- Chronic nonfilers (who fail to cooperate upon recognition)
- Data and analytics
- Whistleblowers (employees, spouses, etc.)
- Nontax investigations (Nationally Coordinated Investigative Unit – NCIU)
- “Problem preparers” – whose fraud is it?





# CRIMINAL FRAUD – WHEN TO SUSPECT AN UPCOMING CID REFERRAL

- Agent starts asking about intent.
- IRS ceases conversation and does not return calls.
- Bank records are summoned.
- Extension of single year examination to multiple years on significant understatement of income or overstatement of deductions.
- A large quantity of documents is requested.



# CRIMINAL FRAUD - INVESTIGATIONS

- IRS will seek to talk with the intended target in a nonthreatening manner (Miranda rights are not required as there is no custodial interrogation) to obtain useful information.
- Criminal Investigation Division personnel travel in pairs; they are permitted firearms.
- A criminal tax attorney should be engaged immediately upon initial contact by IRS – in person or written.



# CRIMINAL FRAUD – POSSIBLE RELEVANT CODE SECTIONS

- 7201 – Tax Evasion
- 7202 – Failure to collect or pay over taxes
- 7203 – Failure to file or pay
- 7204 – False withholding statement (employer)
- 7205 – False withholding statement (employee)
- 7206 – False return or statement – felony (including preparer)
- 7207 – False return or statement – misdemeanor

Additional charges may include conspiracy and money laundering.





# CRIMINAL FRAUD – STRATEGY

- POA becomes sole contact with IRS
- Determine overall strategy (which may change during the process)
- Examine all documents to be turned over for privilege
- Attempt in most cases to build a defense upon lack of willfulness





# CRIMINAL FRAUD – STATUTE OF LIMITATIONS

The statute of limitations for most criminal tax offenses is six years; however, it is three years for certain misdemeanors (not including willful failure to file or pay).



# CRIMINAL FRAUD – USUAL GOVERNMENT PROCESS

- Criminal Investigation Division (CID) may make recommendation of prosecution to Department of Justice (DOJ).
- DOJ will analyze the case for consistency, likelihood of conviction and mitigating factors such as health (conference with Taxpayer Representative usually available).
- Presentation to grand jury by U.S. Attorney's office (not required in misdemeanors).
- US Attorney readies case for trial in absence of plea agreement.





# CRIMINAL FRAUD – STANDARD OF PROOF

- A conviction in a criminal tax case is based on a “beyond a reasonable doubt” standard.
- Less than ten percent of criminal convictions result from trials as most end in pleas.





# FRAUD – A FINAL WORD

- A role of the Taxpayer Representative in an examination is to seek the avoidance of penalties – and in any event no more than the accuracy penalty.
- The role of the Attorney in or post-examination is to dispel the idea of Fraud – and in any event a referral for criminal prosecution.

