D’S LIFETIME TAX LIABILITIES

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78. Handling **D’s lifetime tax liabilities**. Letter 3 and the other representation letters in this System disclaim responsibility for gift and income tax returns and suggest the client use a certified public accountant. However, Letter 3 commits the lawyer to determining the nature and amount of the liabilities of the estate, which includes D’s lifetime tax liabilities. Although addressed to the lawyer preparing income tax returns, this Item 78 is as much for the lawyer reviewing another preparer’s work. Do the following: a. See IRS Publication 559, *Survivors, Executors, and Administrators*, for examples of completed forms.					
b. See Special Instruction 21—Helpful Publications Relating to Federal Tax Matters.					
c. If D died between January 1 and April 15, complete Items 59 and 60 of SDL and be sure that D’s **income tax return**, prepared on IRS Form 1040 (form not provided in this System) for the prior calendar year, has been filed and the tax paid by April 15 of year of D’s death.					
(1) If tax return cannot be filed by April 15 of year of D’s death, do the following: (a) Determine approximate amount of tax due.					
(b) Prepare Application for Automatic Extension of Time to File U.S. Individual Income Tax Return on IRS Form 4868 (form not provided in this System).					
(c) Arrange for signature by D’s surviving spouse, executor or administrator, client, or distributee, or by preparer of return.					
(d) File Application for Automatic Extension of Time to File U.S. Individual Income Tax Return on IRS Form 4868 (form not provided in this System) with, and pay tax to, IRS by April 15.					
(e) Enter extended due date as Item 60a of SDL.					
(2) File the return and pay balance of tax due, if any, within the period of the extension.					
(3) Place copies in file folder entitled “Income Tax Returns.”					

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(4) When finally determined, enter D's share of total income tax liability as Item 26.10 of MIL or D's share of total refund as Item 12.05 of MIL.					
d. Determine whether to continue payments of **estimated income tax** on IRS Form 1040-ES (form not provided in this System), since D's death is not an exception to the penalty for underpayment of those taxes. *Note:* After D's death, the surviving spouse should continue to make the required payments out of funds of that spouse rather than from funds from D's estate. This will avoid a possible inadvertent distribution of estate funds and income. If no other funds are available, consider a loan.					
(1) Enter due dates in office reminder system.					
(2) File declaration with, and pay tax to, IRS by each due date. No transmittal letter is required.					
(3) Place copies in file folder entitled "Income Tax Returns."					
e. Consider making contributions to IRA account for D and D's spouse for the year of D's death.					
f. Determine if D engaged in activities that generated **passive activity losses**. If so, do the following:					
(1) Determine if D had suspended losses from a passive activity. If so, do the following:					
(a) Determine D's adjusted basis in the asset immediately before D's death and subtract that amount from the fair market value of the asset on the date of D's death.					
(b) Determine amount of suspended losses as shown on D's income tax return(s).					
(2) Claim the smaller of the two amounts of the suspended loss on D's final income tax return.					
g. Prepare and file **D's final federal income tax return** on IRS Form 1040 (form not provided in this System) for D's income from January 1 through the date of D's death in the calendar year during which D died. The return must be filed and the taxes paid by April 15 of the calendar year following D's death.					
(1) Review D's records for year of death for information required for D's final income tax return.					

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(2) If **estimated tax** payments had been made by D and D's spouse for calendar year of D's death, consider revising amounts to be paid by D's spouse by revising and filing IRS Form 1040-ES (form not provided in this System). Enter payment dates in office reminder system. Place copy in file folder entitled "Income Tax Returns."					
(3) If tax return cannot be filed by April 15 of the calendar year following D's death, do the following: (a) Determine approximate amount of tax due.					
(b) Prepare Application for Automatic Extension of Time to File U.S. Individual Income Tax Return on IRS Form 4868 (form not provided in this System).					
(c) Arrange for signature by D's surviving spouse, executor or administrator, client, or distributee, or by preparer of return.					
(d) File Application for Automatic Extension of Time to File U.S. Individual Income Tax Return on IRS Form 4868 (form not provided in this System) with, and pay tax to, IRS by April 15.					
(4) Enter extended date as Item 60a of SDL.					
(5) Determine if D or D's spouse had capital loss carryovers. If so, consider selling appreciated property owned by D's surviving spouse and then filing a joint return.					
(6) Determine if D had net operating losses in excess of the combined ordinary income of D and D's spouse. If so *and* if the fiscal year of D's estate closes within the taxable year of the spouses, consider making income distributions to D's spouse from D's estate.					
(7) If D's final return is or was a joint return with D's spouse, compute the deduction for D's share of total income tax liability and enter amount as Item 26.10 of MIL.					
(8) File the return and pay the balance of tax due within the period of the extension. *Note:* It is good practice to file a return for the year of D's death even if no tax is due. If D was not married, it would be appropriate to write "FINAL RETURN" at the top of Page 1 of the return.					
(9) When finally determined, enter D's share of total income tax liability as Item 26.10 of MIL or D's share of total refund as Item 12.05 of MIL.					
(10) Determine whether to request prompt assessment of D's income taxes.					

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(11) Place copies in file folder entitled "Income Tax Returns."					
h. If unable to locate copies of D's income tax returns for the three years before death, consider requesting transcripts or copies from IRS. See Special Instruction 3—Income Tax Returns Can Lead You to Assets and Liabilities and do the following:					
(1) Determine the address used on the return(s), whether D filed separately or jointly for the year(s) in question, and the Internal Revenue Service Center(s) where filed.					
(2) If requesting **transcripts only**, prepare IRS Form 4506-T, Request for Transcript of Tax Return (FF 5). The form is available online at **www.irs.gov** (click on "Order Transcript"). *Note:* If D's surviving spouse was a joint filer with D for the tax year(s) in question, the form may be signed by that spouse. If D was not married and/or if D did not have the same spouse for the tax year(s) in question, the form must be signed by the personal representatives and letters testamentary or letters of administration must be attached. Contact the IRS for alternate instructions if you are trying to obtain transcripts and there is no executor or administrator.					
(a) Arrange for IRS Form 4506-T, Request for Transcript of Tax Return (FF 5), to be signed by proper person.					
(b) If required, obtain letters testamentary or letters of administration. If ordering by mail, determine appropriate number of letters and the correct charge, arrange for payment, charge to client's account, and prepare and send Letter 2 to clerk of court.					
(c) When signed copy of IRS Form 4506-T, Request for Transcript of Tax Return (FF 5), has been returned and all attachments have been obtained, send to the Internal Revenue Service Center. No cover letter is required.					
(d) On receipt of transcripts from the IRS, place in file folder entitled "Income Tax Returns."					

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(3) If requesting **copies** of tax forms, prepare IRS Form 4506, Request for Copy of Tax Return (FF 1). The form is available online at **www.irs.gov/pub/irs-pdf/f4506.pdf**.

Note: If D’s surviving spouse was a joint filer with D for the tax year(s) in question, the form may be signed by that spouse. If D was not married and/or if D did not have the same spouse for the tax year(s) in question, the form must be signed by the personal representatives and letters testamentary or letters of administration must be attached. Contact the IRS for alternate instructions if you are trying to obtain copies of returns and there is no executor or administrator.

(a) Arrange to have IRS Form 4506, Request for Copy of Tax Return (FF 1), signed by proper person.

(b) If required, obtain letters testamentary or letters of administration. If ordering by mail, determine appropriate number of letters and the correct charge, arrange for payment, charge to client’s account, and prepare and send Letter 2 to clerk of court.

(c) When signed copy of IRS Form 4506, Request for Copy of Tax Return (FF 1), has been returned and all attachments have been obtained, determine correct charge, arrange for payment, charge client’s account, and send to the Internal Revenue Service Center. No cover letter is required.

(d) On receipt of copies of tax returns from the IRS, place in file folder entitled “Income Tax Returns.”

(4) Determine if D had not filed income tax returns for prior year(s) and, if not, arrange for missing returns to be prepared.

Note: Old tax forms are at **www.irs.gov/forms-instructions** and **www.unclefed.com**.

i. Determine if D was liable for filing a **gift tax return** for unreported gifts. If so, prepare and file IRS Form 709, United States Gift Tax Return (form not provided in this System), pay tax due, and enter the amount as Item 26.52 of MIL.

Note: D’s gift tax returns must be filed no later than the date for filing D’s federal estate tax return.

(1) Determine if any gift tax returns are presently under audit.

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(2) If unable to determine if D ever filed gift tax returns or if all returns cannot be located, and if executor, administrator, client, heir, beneficiary, or distributee has even the slightest grounds for believing such returns may have been filed, request copies of D’s gift tax returns filed for periods after December 31, 1975, to avoid personal liability when relying on returns obtained from IRS. IRS Form 4506, Request for Copy of Tax Return (FF 1), may be modified and used for this purpose.

Note: It is not wise to file the federal estate tax return before investigating the existence of and then reviewing all of D’s gift tax returns.

(3) If gifts were made to third parties by D’s surviving spouse before D’s death, consider making election to split those gifts.

(4) Determine whether to request prompt assessment of gift taxes.

(5) Place copies of *all* gift tax returns in file folder entitled “Gift Tax Returns.”

j. Determine if D was liable for filing **employer quarterly tax returns**. If so, prepare and file final return on IRS Form 941, Employer’s Quarterly Federal Tax Return (form not provided in this System), pay tax due, and enter the amount as Item 26.51 of MIL. Place copy of return(s) in file folder entitled “Other Tax Returns.”

k. Pay particular attention to the following items:

(1) Medical expenses unpaid on date of D’s death may be deducted as medical expenses on D’s income tax return for the year in which paid or as a debt on federal estate tax return (see Special Instruction 22—Federal Tax Elections and Deductions).

(2) Accrued interest from U.S. Series E and EE bonds may be reported as income on D’s final income tax return.

(3) A joint income tax return may be filed for D and D’s surviving spouse (see Special Instruction 9—Surviving Spouse’s Federal Income Tax Elections).

(4) D’s capital losses and net operating losses expire in the year of D’s final income tax return. Determine whether to increase income on a joint return in the final year to absorb any such losses.

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l. See Special Instruction 3—Income Tax Returns Can Lead You to Assets and Liabilities and review D's income tax returns for the three years before D's death to determine nature of business and itemized deductions and income from businesses and investments, that all income taxes have been paid, if any returns are presently under audit, if claims for refund are pending or should be filed, and if there are unused loss carryovers.					
m. Determine whether to notify IRS of change of address for D. If so, do the following: (1) Determine new address (such as the address of the executor, administrator, surviving spouse, or other person to whom IRS notices should be sent).					
(2) Complete IRS Form 8822, Change of Address (FF 13).					
(3) Arrange to have IRS Form 8822, Change of Address (FF 13), signed by an executor or administrator. If mailing, prepare and send Letter 24 to executor or administrator, together with completed IRS Form 8822, Change of Address (FF 13).					
(4) Prepare and send Letter 31 to IRS, together with completed IRS Form 8822, Change of Address (FF 13).					
n. If any executor or administrator has a change of address, do the following: (1) Complete IRS Form 8822, Change of Address (FF 13), to report a change of address for any executor or administrator.					
(2) Arrange to have IRS Form 8822, Change of Address (FF 13), signed by an executor or administrator. If mailing, prepare and send Letter 24 to executor or administrator, together with completed IRS Form 8822, Change of Address (FF 13).					
(3) Prepare and send Letter 31 to IRS, together with completed IRS Form 8822, Change of Address (FF 13).					
o. Determine if D owned a **partnership** interest in which the **tax basis** of D's interest should be **adjusted** under IRC Section 743 (see Item 16.53 of MIL). If so, see that the partnership makes the election under IRC Section 754 for the taxable year of the partnership during which D's death occurred. Place copy in file folder entitled "Partnerships, Trusts, and Other Unincorporated Businesses."					