

Anatomy of an IRS 706 Dispute

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Education/Honors

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Table of Contents

01

Purpose of Form 706

02

Timing Requirements to File
Form 706

03

IRS Closing Letters and Audit
Authority

04

IRS Audit Process
Examination
Appeals
Litigation

05

Audit Statistics and Trends

06

Changes at the IRS

07

IRS Scrutiny Trends

08

Key Takeaways

09

Q&A

PURPOSE OF FORM 706 01

Purpose of Form 706

U.S. Estate Tax Compliance and Reporting

- Filed by executor to report estate assets and calculate estate tax liability
- Filing requirements
- **Instructions to file Form 706:** See www.irs.gov/instructions/i706

TIMING REQUIREMENTS TO FILE FORM 706

02

Timing Requirements to File Form 706

U.S. Estate Tax Filing Timing

- Within 9 months after the date of the decedent's death
- 6-month extension of time to file is available
 - Form 4768, Application for Extension of Time To File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes
- Consequences of failure to file
- Where to file Form 706:
 - Department of the Treasury
 - Internal Revenue Service
 - Kansas City, MO 64999
- If using a private delivery service:
 - Internal Revenue Submission Processing Center
 - 333 W. Pershing Road
 - Kansas City, MO 64108

IRS CLOSING LETTERS AND AUDIT AUTHORITY

03

IRS Closing Letters and Audit Authority

Estate Tax Closing Letters

- Must request via **pay.gov**
- Wait at least 9 months after filing Form 706 to request closing letter

IRS Audit Authority

- IRS has 3 years to audit Form 706 from the date filed or the date due, whichever is later
 - 6-year statute of limitations ("SOL") if assets are understated by 25% or more
 - No SOL when false or fraudulent return has been filed with intent to evade tax
- Audits are conducted by Estate & Gift Tax Field Examination teams
 - Field Estate and Gift Tax Examiners
 - Group Managers
 - May include teams from Large Business and International (LB&I) for large estates or Small Business/Self-Employed (SB/SE) for smaller estates

IRS AUDIT PROCESS 04

EXAMINATION
APPEALS
LITIGATION

IRS Audit Process

IRS Audit Letter

- The IRS may audit a taxpayer to review or examine books, accounts, and financial records to:
 1. ensure the information reported on the taxpayer's tax return is correct according to the tax laws and
 2. verify that the reported tax amount is accurate.
- An audit can conclude with:
 1. no change,
 2. taxpayer agreement with the IRS's proposed changes, or
 3. taxpayer disagreement with the IRS's proposed changes.
- **How is the taxpayer put on notice that the IRS is contesting the filing?**

To: (Name of Taxpayer and Company Division or Branch)

[Redacted]

Subject

SAN number

Submitted to:

Dates of Previous Requests (mm/dd/yyyy)

Please return Part 2 with listed documents to requester identified below

Description of documents requested

F. Regarding Form 706:

- 1) What asset(s) or interest(s) did Decedent receive in exchange for the debt?
- 2) Are the assets or interests received in exchange for the Payable, reported on Decedent's Form 706? If not, were the assets or interests gifted or sold?
- 3) Why did Decedent take out these loans?
- 4) [Redacted]
- 5) Outline the amounts borrowed and lent by individuals other than the decedent.
- 6) Is there a promissory note or other evidence of indebtedness? (please provide);
- 7) What was the interest rate charged?;
- 8) Was there any security or collateral?;
- 9) Did the Decedent pay principal and/or interest on the loans from [Redacted] (including the line of credit)? If so, please provide documentation. Also, please provide amortization schedules.
- 10) Regarding the Line of Credit, please provide a copy of the statement (showing the outstanding balance) for the line of credit as of the Date of Death of Decedent.
- 11) What was the total amount of the Line of Credit when it was first established, and when did Decedent first draw down on the Line?
- 12) What was the highest amount drawn down on the Line?
- 13) Was there a fixed maturity date?;
- 14) Was there a demand to enforce the Notes or the Line, and was any actual repayment made? (please provide proof);
- 15) [Redacted]
- 16) Did the Decedent have the ability to repay the Note or the Line when executed?;
- 17) Please provide any records maintained by the entity that made the loan to Decedent reflecting the transaction as a loan; and
- 18) Please provide proof of the manner in which the transaction was reported for Federal Tax purposes consistent with a loan.

G. General Questions:

- 1) Please provide copies of all general powers of attorney executed by the Decedent.
- 2) What percentage of the Decedent's assets were transferred [Redacted]
- 3) How did the Decedent maintain his lifestyle and pay for expenses?
- 4) What was the business purpose for the formation of each of the following entities: [Redacted]
- 5) Provide a detailed explanation of any significant non-tax purposes for the formation of the entities outlined above.
- 6) What family members are involved in the entities?
- 7) Did any beneficiaries who received gifts [Redacted] make capital contributions or transfer property [Redacted]?
- 8) What was [Redacted] involvement with the entities and why was he selected as manager of [Redacted]?
- 9) What advice was the Decedent given concerning the formation of the entities and by whom?

Information Due By

At Next Appointment ☐

Mail in ☐

From:

Name and Title of Requester

[Redacted]

Employee ID number

[Redacted]

Date (mm/dd/yyyy)

[Redacted]

Office Location

[Redacted]

Telephone Number

[Redacted]

IRS Audit Process (continued)

Examination

- **Does the IRS communicate the number it believes more appropriate early on?**
- **Is the IRS in a “take no prisoners” mindset in the early stages of an audit?**
- **When does the “9-page, single-spaced letter filled with interrogatories” arrive?**

IRS Audit Process (continued)

Examination Letter

EXHIBIT A

Internal Revenue Service

Department of the Treasury

Date:

In Reply Refer to:

Person to Contact:

Contact Telephone Number:

Fax Number:

Re:

Dear

The United States Gift Tax Return you filed for the year _____ is being audited by this office. We need the information listed below furnished or made available for our inspection within the next three (3) weeks:

1. Copies of donor's Federal Income Tax Returns (1040) for the year before, the year of and the year after the gift referenced above.
2. Copies of all 709's filed with appraisals, acts of donation and other supporting documentation. This includes 709's filed by your spouse.
3. If any assets subject to any of the above referenced gifts have been sold or agreements to sell have been entered into subsequent to date of donation please provide complete details, including contracts, deeds and closing statements.

IRS Audit Process (continued)

Examination Letter

4. A list of donations of any kind, other than customary holiday and birthday gifts of small value, made during your life time regardless of whether a Gift Tax Return Form 709 was filed.
5. If the object of any of the above donations was an interest in any closely held corporation, partnership, limited liability company or other business organization, we need the following:
 - a) All documents relating to the creation of the entity (including bills) from any attorney, accountant or firm involved in recommending the creation of the entity or in drafting the necessary documents. If a claim is made that any of these documents are privileged, identify each privileged document by date, source, audience, and reason for the privilege.
 - b) Articles of organization and operating agreement, with any amendments.
 - c) All documents that were prepared to meet state law requirements on the formation and operation of the entity.
 - d) All financial statements and tax returns prepared and/or filed since inception.
 - e) All of the entities' bank and other records (i.e., general ledger, cash receipts and disbursements journals, check registers, etc.) which reflect the amount and nature of all deposits and distributions, including distributions to owner/members, for the period since the entity was formed to the current period.
 - f) Minutes of all meetings; if none, indicate the dates of all meetings and the business discussed.
 - g) Evidence showing how the value of each entity asset was arrived at as of the date:
 1. it was contributed to the entity;
 2. of each gift of an interest in the entity;

provide all appraisals and supporting workpapers.

IRS Audit Process (continued)

Examination Letter

- h) Evidence as to how the entity was valued as a whole as well as fractional interest. Provide all appraisals if not already furnished.
- i) Evidence to substantiate all initial and subsequent capital contributions and the source of all contributions by owners other than the donor.
- j) For any entity asset that has been sold or offered for sale since the formation of the entity, provide evidence which documents the sale or attempted sale (i.e., sales agreement, listing agreement, etc.).
- k) For each entity asset, explain/provide:
 - 1. evidence that the entity owns the asset;
 - 2. when the donor acquired the asset;
 - 3. how the asset was used by the donor since its acquisition and how the entity has used the asset since; and
 - 4. who managed the asset prior to and after its contribution, explain in detail what management consisted of and how it changed after the entity was formed.
- l) Brokerage statements reflecting the ownership and activity of the securities and mutual funds contributed to the entity for the period beginning one year prior to the formation of the entity and continuing through the current date, and copies of any other tax returns and financial statements which reflect the activity of the entity's assets, if different from the foregoing.
- m) For each gift or transfer of an interest, provide:
 - 1. evidence that the interest was legally transferred under state law and under the terms of any agreement among the owner/members.
 - 2. any assignment of any interest along with the terms of the assignment;
 - 3. the amount and source of any consideration paid along with an explanation as to how the amount was arrived at.

IRS Audit Process (continued)

Examination Letter

- n) Provide the following with respect to the donor, all other original members and any recipients of gifts or transfers of interests:
 - 1. date of birth;
 - 2. education and occupation;
 - 3. experience and expertise in dealing with real estate, financial affairs and investments;
 - 4. extent of the donor's investments as of the date of the formation of the entity, including a summary of assets that were not contributed to the entity; provide tangible evidence thereof; and
 - 5. any personal financial statements and credit applications which were prepared in connection with loan applications after the LLC was created.
- o) Indicate whether the entity is currently in existence, and, if so, provide the current ownership interests.
- p) Provide a summary of any other transfers of business interests not reflected in the gift tax returns filed.
- q) A statement describing the donor's state of health at the time of the formation of the entity and for the six month period prior thereto, including a description of any serious illnesses. Please also provide the names, addresses and telephone numbers of all doctors who would have knowledge of the donor's state of health during this period to the present date and provide these doctors with authorization to respond to the Service's future requests for information, including a copy of the medical records, in necessary.
- r) A copy of the Donor's will, revocable trust, and any executed power of attorney, if not submitted with the return.

IRS Audit Process (continued)

Examination Letter

- s) A statement indicating the identity of the parties recommending the use of the LLC or partnership, when the recommendations were made, and the reasons set forth in support of using such an entity.
- t) Names, addresses, and current telephone numbers of the representatives of the Donor/Estate, all donees/beneficiaries, all partners or members, accountants/bookkeepers, and brokers/investment advisors.

Each item should be responded to either by furnishing the requested documentation; a written response, if called for, under the signature of the donor or a written explanation as to why the information will not be provided.

Should you have any questions call or write to me at the above number and address. A Form 2848 is enclosed for your execution if you wish to appoint your attorney or CPA to represent you.

Very truly yours,

Enclosures:

IRS Publication 1

Form 2848 Power of Attorney

IRS Audit Process (continued)

Appeals

- Taxpayer can request to exhaust administrative remedies through IRS Appeals (if enough time remains on the statute)
- Taxpayer also can request mediation

What are the strategic decisions in Appeals?

- Garden variety: valuation, concession of legal issues; giving up a small matter to reach an acceptable outcome
- Clients are often interested in the dollars coming out of their pocket and not necessarily the legal reason

IRS Audit Process (continued)

Appeals Officer Training Coursebook

- *Valuation Training for Appeals Officers Coursebook*
 - Methods for valuing real estate, tangible personal property, art objects and collectibles, preferred stock, and intangible assets and intellectual property
 - Financial analysis and valuation of a closely held corporation
- Cites readings from *Valuing a Business, the Analysis and Appraisal of Closely Held Companies*, by Dr. Shannon P. Pratt.

Appeals Level Resolutions and Legal Concessions

- **Given fewer IRS resources in recent years, if they select an estate for a fight, does it mean they intend to contest to the end?**

IRS Audit Process (continued)

U.S. Tax Court

- Cost
- Trier of Fact
- Venue
- Publicity

U.S. District Court

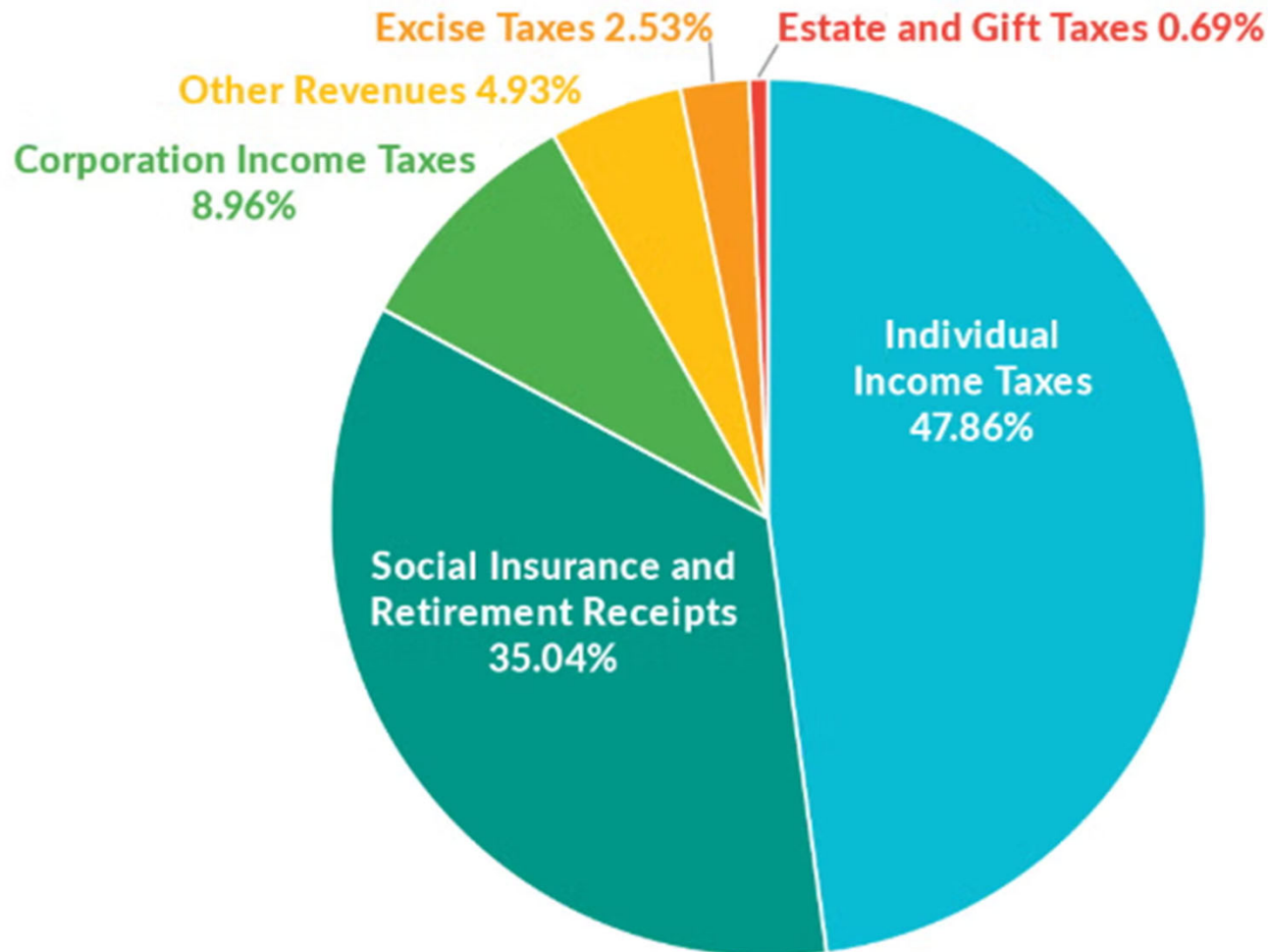
- Cost
- Trier of Fact
- Venue
- Publicity

AUDIT STATISTICS AND TRENDS

05

Audit Statistics and Trends

The Estate Tax Comprises Less than One Percent of Federal Revenue



Source: OMB, Historical Tables, Table 2.1 and Table 2.5

TAX FOUNDATION

@TaxFoundation

Audit Statistics and Trends (continued)

The Internal Revenue Service is seeing more estate tax returns and revenue (2021 v. 2020).

- In 2021, 6,158 estate tax returns filed; 42% of returns were taxable returns
 - 369 taxable returns were >\$50mm
- Audit rate for estates: all ~29%; >\$10mm ~22%

Source: <https://www.irs.gov/pub/irs-prior/p55b--2022.pdf>; <https://www.wealthmanagement.com/estate-planning/irs-sees-increase-in-number-of-estate-tax-returns-filed-amount-of-taxes-paid>.

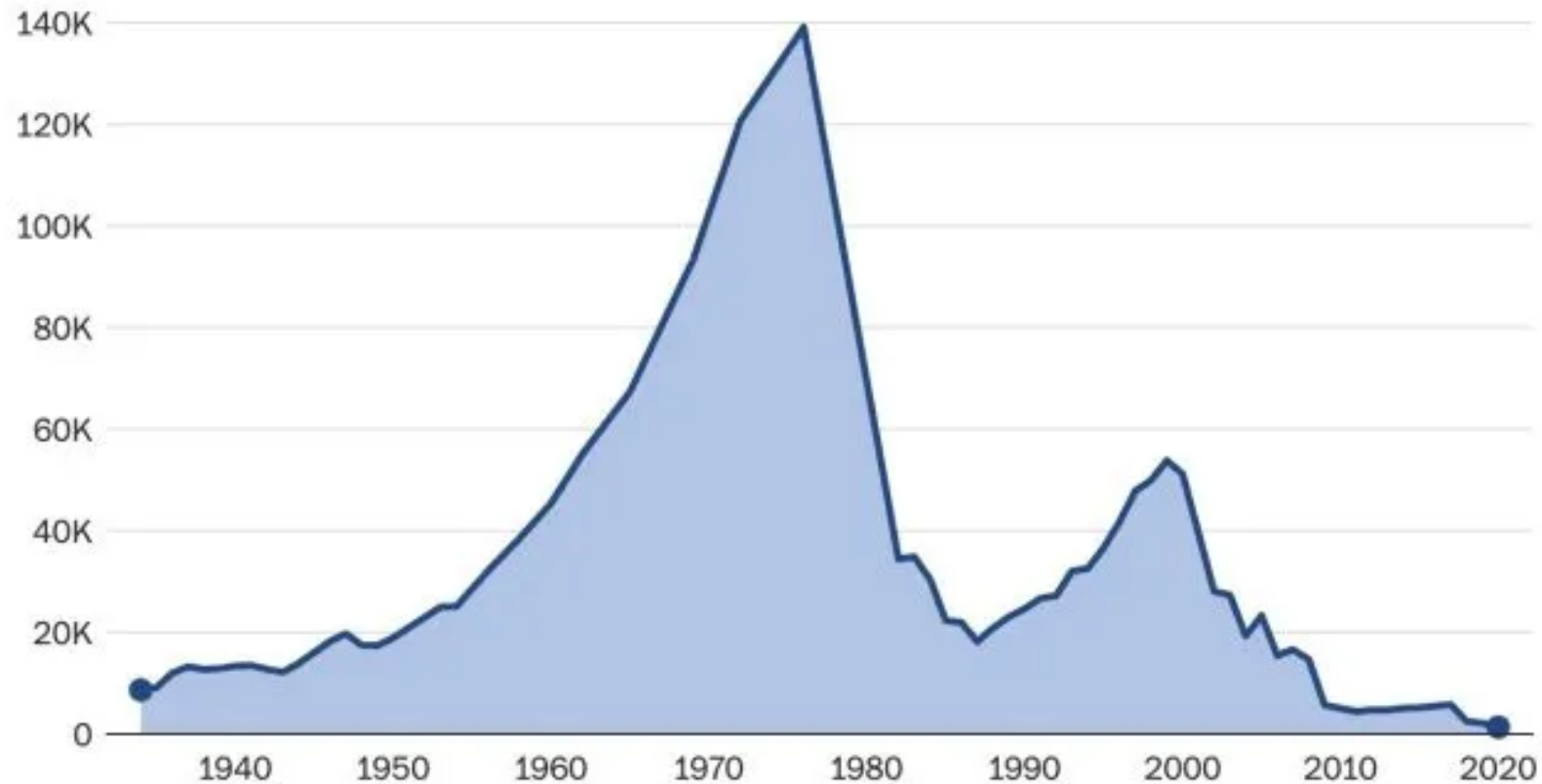
Tax status and size of gross estate	Taxable estate	
	Number	Amount
All Returns	5,790	\$92,659,653
Under \$10 million	507	\$2,879,900
\$10 million under \$20 million	3,071	\$30,935,931
\$20 million under \$50 million	1,645	\$26,748,328
\$50 million or more	567	\$32,095,494
All Taxable Returns	2,584	\$67,926,059
Under \$10 million	233	\$1,544,505
\$10 million under \$20 million	1,118	\$14,876,755
\$20 million under \$50 million	865	\$20,663,388
\$50 million or more	369	\$30,841,411

Source: https://taxpolicycenter.org/sites/default/files/statistics/pdf/estate_returns_taxable_7.pdf.

Audit Statistics and Trends (continued)

Almost nobody pays the estate tax

Taxable estate-tax returns in the U.S., by death year



Note: The estate tax was temporarily repealed in 2010, so we left it off this chart.

Source: [Internal Revenue Service](#)

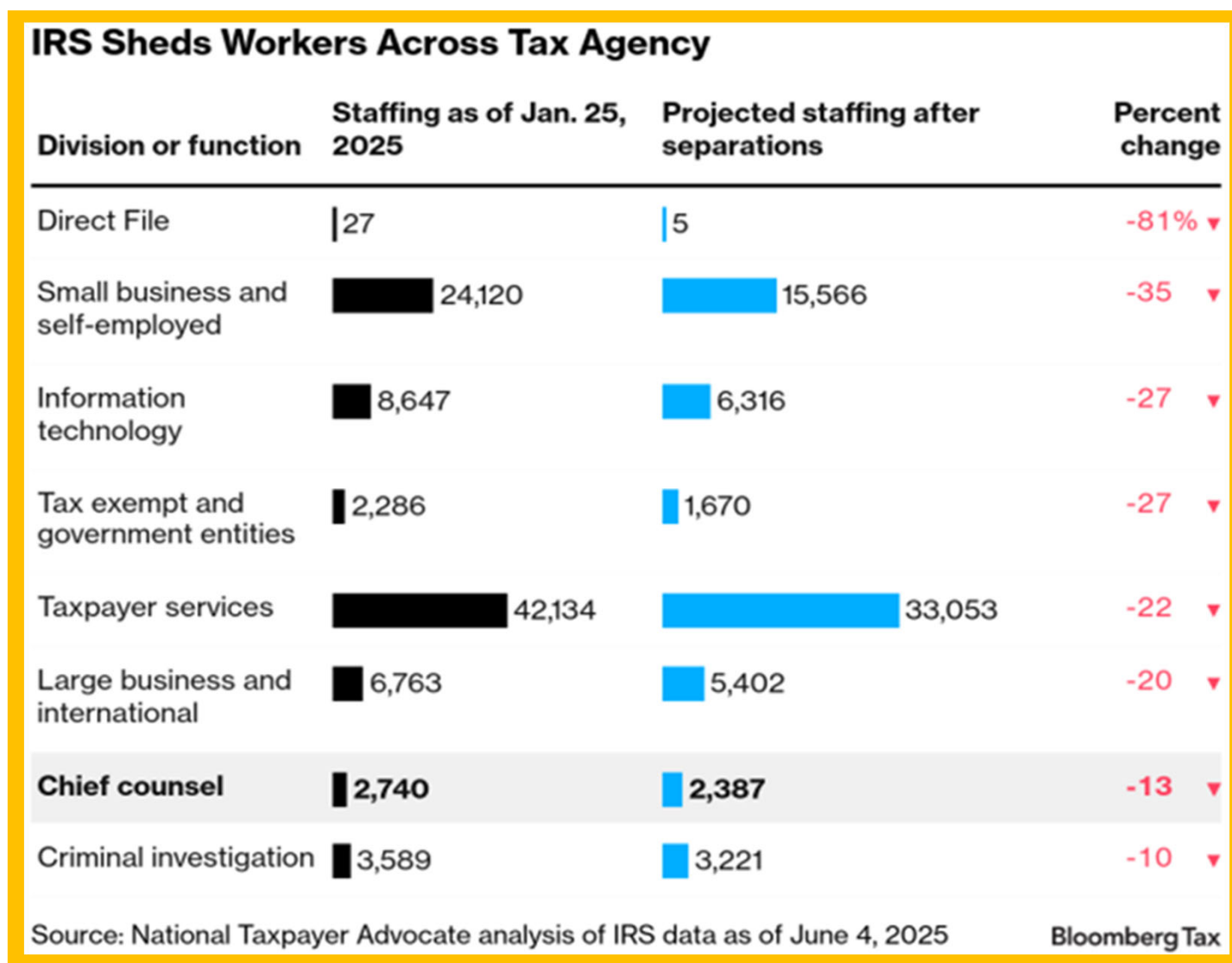
DEPARTMENT OF DATA / THE WASHINGTON POST

Important Valuation Cases

<u>Case</u>	<u>Assets</u>	<u>Court</u>	<u>Discount from NAV/ Proportionate Entity Value</u>
<i>Strangi I</i> (2000)	securities	Tax	31%
<i>Knight</i> (2000)	securities/real estate	Tax	15%
<i>Jones</i> (2001)	real estate	Tax	8%; 44%
<i>Dailey</i> (2001)	securities	Tax	40%
<i>Adams</i> (2001)	securities/real estate/minerals	Fed. Dist.	54%
<i>Church</i> (2002)	securities/real estate	Fed. Dist.	63%
<i>McCord</i> (2003)	securities/real estate	Tax	32%
<i>Lappo</i> (2003)	securities/real estate	Tax	35.4%
<i>Peracchio</i> (2003)	securities	Tax	29.5%
<i>Deputy</i> (2003)	boat company	Tax	30%
<i>Green</i> (2003)	bank stock	Tax	46%
<i>Thompson</i> (2004)	publishing company	Tax	40.5%
<i>Kelley</i> (2005)	cash	Tax	32%
<i>Temple</i> (2006)	marketable securities	Fed. Dist.	21.25%
<i>Temple</i> (2006)	ranch	Fed. Dist.	38%
<i>Temple</i> (2006)	winery	Fed. Dist.	60%
<i>Astleford</i> (2008)	real estate	Tax	30% (GP); 36% (LP)
<i>Holman</i> (2008)	Dell stock	Tax	22.5%
<i>Keller</i> (2009)	securities	Fed. Dist.	47.5%
<i>Murphy</i> (2009)	securities/real estate	Fed. Dist.	41%
<i>Gallagher</i> (2011)	publishing company	Tax	47%
<i>Koons</i> (2013)	cash	Tax	7.5%
<i>Richmond</i> (2014)	marketable securities	Tax	46.5% (37% LOC/LOM & 15% BIG)
<i>Giustina</i> (2016)	timber company	Tax	25% LOM
<i>Streightoff</i> (2018)	marketable securities	Tax	18% LOM
<i>Grieve</i> (2020)	marketable securities	Tax	35% (98.8% non-vot. LLC int.)
<i>Nelson</i> (2020)	equipment co.	Tax	40.5% (stock); 31.6% (LP)
<i>Cecil</i> (2023)	real estate/hospitality	Tax	20% LOC/19 – 27% LOM

CHANGES AT THE IRS 06

Changes at the IRS



Bloomberg Tax, August 26, 2025 (crediting National Taxpayer Advocate)

Changes at the IRS (continued)

Over 20 Percent of TAS Employees Have Taken Resignation Offer

POSTED ON MAY 22, 2025

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By

tn BENJAMIN VALDEZ
Message the Author

affect caseloads.

National Taxpayer Advocate Erin Collins said she expects to lose up to 25 percent of Taxpayer Advocate Service staff to the deferred resignation program and that the departures have already begun to

Changes at the IRS (continued)

IRS Chatbot Performance Lags Amid Staff Cuts

TAX NOTES INVESTIGATES

POSTED ON MAY 21, 2025

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LAUREN LORICCHIO

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Artificial intelligence tools like chatbots are supposed to become more effective over time. Data indicate the IRS's are getting worse, just as the agency is increasingly relying on them amid **staffing** cuts.

Changes at the IRS (continued)

IRS Staff Cuts Will 'Substantially' Boost Deficits, Group Says

DATED MAY 12, 2025

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SUMMARY BY TAX ANALYSTS

IRS workforce reductions are unprecedented and “will produce negative fiscal consequences for working- and middle-class Americans,” making the U.S. tax system less fair and contributing to budget deficits, the Center for American Progress said in a May 12 article.

Changes at the IRS (continued)

Over 400 IRS Appeals Employees Took Resignation Offers

POSTED ON MAY 12, 2025

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Roughly 425 employees have accepted offers to resign from the IRS Independent Office of Appeals by the end of the fiscal year, with over 70 offers still outstanding, according to an agency official.

Changes at the IRS (continued)

- **How do you best reach the IRS?**
 - Letters/faxes—sure, but you likely will receive Letter 96C in response

Dear Taxpayer:

We received your Form 843 and are forwarding your request to our Estate Tax Attorney for review. Allow 60 - 90 days for your request to be processed.

Find tax forms or publications by visiting [IRS.gov/forms](https://www.irs.gov/forms) or calling 800-TAX-FORM (800-829-3676).

If you have questions, you can call Estate & Gift at 866-699-4083 between 10:00 a.m. and 2:00 p.m. EDT.

Changes at the IRS (continued)

- IRS Estate & Gift fax numbers:
 - (855) 386-5127
 - (855) 386-5128
- IRS Estate & Gift phone number:
 - (866) 699-4083
- Only answered 9:00 a.m. to 1:00 p.m. Central
 - Pack your patience

IRS SCRUTINY TRENDS 07

IRS Scrutiny Trends

IRS Scrutiny Trends

- **What things often lead to an audit?**
- Common IRS challenges:
 - Valuation
 - Formula transfers
 - QTIP termination
 - Promissory notes
 - Installment sales to intentionally defective grantor trusts
 - GRATs
 - Penalties
 - Section 2036
 - Split-dollar life insurance

KEY TAKEAWAYS 08

Key Takeaways

Best Practices for “Audit Proofing”

- Is there a way to avoid an audit completely?

Prepare for an Audit

- Your files could be subpoenaed—including emails
- You might have to testify about reasons for creating entity
- Help your client—best evidence of nontax reasons comes from contemporaneous correspondence (see *Stone, Schutt*)
- Okay to discuss tax attributes, but talk about nontax attributes and reasons too (see *Stone, Schutt, Mirowski*)

Q&A 09

Q&A

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