



# TaxNewsFlash

United States



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## U.S. Tax Court: Gift tax assessment time-barred (updated with KPMG observations)

The U.S. Tax Court today released a memorandum opinion granting the taxpayer's motion for summary judgment because the IRS failed to assess gift tax within three years from the date the taxpayer filed a gift tax return and thus the period of limitations for assessment of gift tax had run.

The case is: *Schlapfer v. Commissioner*, T.C. Memo 2023-65 (May 22, 2023). Read the Tax Court's [opinion](#) [PDF 205 KB] (19 pages)

This report was updated on May 24, 2023, to include KPMG observations.

### Summary

The taxpayer was the policyholder of a life insurance policy issued in 2006. The policy was funded by stock and cash from a Panamanian corporation solely owned by the taxpayer that managed investments and held marketable securities and cash. In 2007, the taxpayer assigned ownership of the policy to his mother, aunt, and uncle.

The taxpayer in 2012 entered into the IRS Offshore Voluntary Disclosure Program (OVDP), which "offered U.S. taxpayers with undisclosed income from offshore assets a compliance avenue to resolve income tax liabilities" and "tax information reporting obligations." As part of his participation in the OVDB, on November 20, 2013, the taxpayer submitted a disclosure packet in which he included a 2006 gift tax return that attached a protective filing describing a gift of \$6,056,686 of Panamanian corporation stock but indicating that this gift was not taxable under Treas. Reg. § 25.2501-1 because it was a gift of intangible personal property from a non-domiciled foreign citizen. Later, on June 14, 2016, the taxpayer signed a Form 872 for his 2006 gift tax return, agreeing to extend the time to assess tax until November 30, 2017.

**KPMG observation:** It seems somewhat likely given the facts and circumstances described in the

opinion that the taxpayer was actually a domiciliary of the United States at the time of the gift and thus subject to gift tax to the extent the value of the gift exceeded his remaining lifetime exemption (\$1 million for 2006 and 2007). This is because he had lived in the U.S. for a very long time (since 1979), possessed a green card, had a number of family ties to the United States, applied for citizenship in 2007, and became a citizen in 2008. However, because the Court determined that the time for assessment of gift tax had expired, it was unnecessary to resolve the taxpayer's domicile status.

The IRS, in August 2016, issued the taxpayer a Form 3233 (Report of Gift Tax Examination) for his 2006 gift tax return. In the report, the IRS concluded that there were no taxable gifts in 2006 because the taxpayer failed to relinquish dominion and control of the policy until 2007. In addition, because the gifts were allegedly made in 2007, not 2006, and the taxpayer failed to file a gift tax return for 2007, the IRS argued that he did not adequately disclose the gifts to commence the period of limitations on assessment. Because the taxpayer refused to concede that the gift was made in 2007, he was given the choice to opt out of or be removed from the OVDP, and he withdrew.

After the taxpayer formally withdrew from the OVDP, the IRS prepared a substitute gift tax return for 2007 pursuant to section 6020(b). On October 17, 2019, the IRS issued the taxpayer a notice of deficiency for 2007 determining a gift tax liability of \$4,429,949, and additions to tax under section 6651(a)(2) and (f) of \$4,319,200. The taxpayer then filed a petition with the Tax Court challenging the IRS' determinations.

The IRS filed a motion for summary judgment asking the Court to find as a matter of law that (1) the taxpayer made taxable gifts of an insurance policy in 2007 and (2) that he is liable for additions to tax under section 6651(f), or in the alternative section 6651(a)(1) and (2). The taxpayer filed a cross-motion for summary judgment asking the Court to find as a matter of law that the period of limitations to assess the gift tax expired before the notice of deficiency was issued because the taxpayer adequately disclosed the gifts on his 2006 gift tax return.

### **Tax Court decision**

The Court noted that the IRS generally has three years from the filing of a gift tax return to assess additional tax. If no return is filed, or if the gift is not adequately disclosed on or with the gift tax return, then the IRS may assess at any time.

The Court further stated that when the gifts were completed was immaterial. Even if the Court were to decide that the gifts were completed in 2007, the taxpayer's adequate disclosure of incomplete gifts on his 2006 return would suffice to commence the three-year period of limitations upon the filing of that return in accordance with Treas. Reg. § 301.6501(c)-1(f)(5).

The Court found that the taxpayer adequately disclosed the gifts on his 2006 gift tax return because the documents he attached to, and referenced in, his return provided the IRS with enough information to satisfy adequate disclosure. The Court specified that both the return itself, and all documents accompanying the return (e.g., the protective filing, all relevant Forms 5471 for the Panamanian corporation, and the offshore entity statement related to same), must be considered in determining whether the taxpayer adequately disclosed the gifts.

**KPMG observation:** The Court cited various cases as standing for the proposition that adequate disclosure can be satisfied not only by the content of the gift tax return and its attachments but also by information contained in returns and documents that are referenced in the gift tax return. It went on to give two additional reasons for why the offshore entity statement should be taken into account: (1) that it was included in the same disclosure packet of documents as the 2006 gift tax return when the OVDP filing was made, and (2) that the protective filing attached to the gift tax return referred to a gift of "controlled foreign company stock" such that the IRS was on notice that they should look at the offshore entity statement. This seems to be quite an expansive view of the range of information that can contribute to satisfying the adequate disclosure requirements. It is unclear whether the Court would have taken these additional filings into account if they had been filed completely separately in the ordinary course (i.e., not in an OVDP context).

The Court further found the fact that the taxpayer may have failed to strictly satisfy all applicable requirements of Treas. Reg. § 301.6501(c)-1(f)(2) to be irrelevant and that, in any event, the taxpayer substantially complied with those requirements.

For example, even though the gift tax return described the property transferred as the Panamanian corporation stock instead of the life insurance policy, the Court found this description sufficient to alert the IRS to the nature of the gift. In addition, the Court found that the offshore entity statement's reference to the taxpayer's mother as the recipient of the stock was substantial compliance with the adequate disclosure requirements even though it did not mention the other two donees, the taxpayer's aunt and uncle. Finally, the financial information contained in the Forms 5471 and the offshore entity statement (e.g., balance sheets, statements of net earnings, dividends paid, and operating results) was deemed sufficient to apprise the IRS of the basis for the value of the gift reported on the return.

Because the taxpayer adequately disclosed the gifts on his 2006 gift tax return, the period of limitations to assess the gift tax commenced when the return was filed in 2013; and because the IRS issued the notice of deficiency in 2019 more than three years (plus the agreed to extension of one year) after the filing, the IRS was barred from assessing gift tax.

**KPMG observation:** This decision seems to be very taxpayer friendly. It allows the piecing together of information submitted on various forms and attachments and interprets the facts in the best light possible in reaching the conclusion that the taxpayer substantially complied with the adequate disclosure requirements. Due to the special OVDP submission context, it remains to be seen whether this same permissive approach will be applied broadly or consistently to more typical gift tax returns filed in the normal course. To ensure that the statute of limitations runs from the date of filing, it is still best to make every effort to strictly comply with the adequate disclosure requirements.

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