



# IN PRACTICE...with CNA®

A Practitioner's Perspective on Emerging Legal Trends | 2022 Issue 5

## Second Chances Abound: Opportunities for Correcting Certain Omissions and Mistakes in Tax Elections

*"Ignorantia juris quod quisque tenetur scire, neminem excusat."*

Latin, philosophy and legal scholars alike may recognize this Latin phrase which roughly translated declares, "Ignorance of the law, which everyone is bound to know, excuses no one". While this principle may be unforgiving, it is important to recognize that in practice, the tax law and in particular the tax regulations can be forgiving when it comes to failing to make timely tax elections. Understanding these opportunities for forgiveness can be an important tool in avoiding legal and accounting malpractice claims which involve tax law. Specifically, when tax practitioners make certain filing errors, particularly as to making tax elections, the potential exists for significant tax liability for their clients, and thus professional liability for the law firm. Practitioners should be mindful that relief (forgiveness of a sort) may be found in Treasury Regulation (Treas. Reg.) §301.9100-2 et seq.

### §301.9100 Relief in General

Treas. Reg. §301.9100-2 et seq. grants the Commissioner of the Internal Revenue Service (IRS) the authority to grant taxpayers relief from certain filing errors.<sup>1</sup> 9100 relief does not cure improper filings, but it does allow taxpayers an opportunity to correct missed deadlines for making tax elections. Treas. Reg. §301.9100-2 et seq. provides standards for the IRS to use in determining whether to grant extensions of time to make both statutory and regulatory elections<sup>2</sup> (but no more than six months except in the case of a

taxpayer who is abroad) when the taxpayer has failed to do so on a timely basis. In evaluating the propriety of 9100 relief for their clients, practitioners must first consider whether the extensions they seek are automatic or discretionary.

### Automatic Extensions

Reg. §301.9100-2 provides automatic extensions of time for making regulatory and statutory elections when the deadline is concurrent with the due date for the filing of the return, including extensions in the form of either 6-month or 12-month extensions.

### Automatic 6-Month Extension Under §301.9100-2

For clients who timely filed their original return but discovered an error almost immediately after filing, an automatic 6-month extension is available. This relief requires that taxpayers file before the extended due date of the original return to make an election, attach necessary documents, and take corrective action within the extended due date of the original return. This extension is generally automatic, provided that corrective action is taken by the taxpayer via filing an amended return using the same address as the original return, with all required attachments, and the phrase "Filed pursuant to §301.9100-2(c)" written on the top of the statement.

<sup>1</sup> Those regulations were subsequently amended and expanded in both 1993 and 1997.

<sup>2</sup> A "statutory election" is an election whose due date is set by statute (i.e., the Internal Revenue Code), whereas a "regulatory election" is one whose due date is prescribed by a regulation published in the Federal Register, or a revenue ruling, revenue procedure, notice, or announcement published in the Internal Revenue Bulletin.

### Automatic 12-Month Extensions Under §301.9100-2

Corrective action is also possible under the automatic 12-month rule when an original return was not filed timely for certain regulatory elections. To obtain a 12-month extension, the taxpayer must file an amended return using the same address as the original return, with all required attachments, and the phrase "Filed pursuant to §301.9100-2(c)" written at the top of the statement. Similar to the 6-month extension, these are also generally automatic, and are available for the following regulatory elections:

Income Tax	Gift Tax	Estate Tax
IRC §444 – Election to use other than a required taxable year	IRC §2701(c)(3)(C)(i) – Elections to treat a qualified payment right as other than a qualified payment	IRC §2032A(d)(1) – Elections to special value qualified real estate
IRC §472 – Election to use LIFO inventory method	IRC §2701(c)(3)(C)(ii) – Elections to treat any distribution right as a qualified payment	
IRC §501(c)(3), (9), (17), (20), §508, and §528 – Election to file applications for certain exempt organizations and homeowners associations		
IRC §754 – Election to adjust basis on certain transfers of partnership interests		

No request for a Private Letter Ruling (PLR) or user fees are necessary to obtain these automatic extensions.

**Example 1:** Income tax elections that are connected to the death of partner can be problematic. The tax preparer many times does not find out about the death of a limited partner or investor in a limited liability company (LLC) until many months after the partnership return is filed. If you found out with sufficient time to file under §301.9100-2, automatic relief should be granted. However, if you miss the automatic 12-month extension, you may still be able to qualify for relief under §301.9100-3. See Non-Automatic Discretionary Extensions below.

### Non-Automatic Discretionary Extensions

Despite the breadth of relief offered under §301.9100-2, lawyers may find that their clients with errors or missed election deadlines do not meet the criteria for an automatic extension. In such cases, other avenues for 9100 relief may exist. For example, in the event that a practitioner discovers that their client has surpassed an automatic 6 or 12-month extension period, Reg. §301.9100-3 provides the Commissioner with the discretion to grant extensions for making regulatory election requests. These discretionary extensions are generally made in the form of PLR requests, and require the taxpayer to establish that they: 1) acted reasonably; 2) relied on a qualified tax professional; 3) discovered the error before the IRS; 4) acted in good faith; and 5) that granting relief will not prejudice the interests of the government.

There are a wide variety of "elections" to which non-automatic relief might apply, including late elections or flawed elections under:

- Reg. §1.338 for corporations making qualified stock purchases;
- Reg. §301.7701-3 late entity classification elections;
- Reg. §1.414(r)-1 employer election regarding qualified separate lines of business for qualified plan testing purposes;
- Reg. §1.884-1(d)(3) late elections to extend the time to assess branch profits tax;
- Reg. §1.1361-1 late elections for Qualified Subchapter S Corporation Trusts (QSST); and Electing Small Business Trusts (ESBT);
- Reg. §1.1361-2 late elections for Qualified Subchapter S Subsidiaries (QSUB).

**Example 2:** S Corporation issues come in several shapes and sizes under IRC §1361 (late elections) and §1362 (inadvertent terminations due to non-qualified shareholders). Some shareholders may hold the ownership of their S Corporation stock in their revocable trust at death. While the trust was a qualified shareholder during life, it may cease to be a qualified shareholder two years after death. The failure to make a timely QSST or ESBT election can be cured by filing a PLR request under §301.9100-3, and the S Corporation status can be preserved.

**Example 3:** Similarly, after formation and the filing of a timely S election, if it is later discovered that a single member LLC shareholder (i.e., a disregarded entity) is actually a disqualified shareholder (because it either represents preferred stock or is a multi-member LLC/partnership), then the required termination of the S Corporation can be avoided under §301.9100-3 by agreeing to reform the LLC and filing a PLR request.

### Special Rules for Change of Accounting Methods and Periods

Other scenarios may also qualify for 9100 relief, including changes to accounting methods or periods, such as when an improper tax year may have been adopted or when the taxpayer seeks to change the overall system of accounting and/or treatment of any material item.

Reg. §301.9100-3(c)(2) and (3) both acknowledge that the interests of the government are deemed to be prejudiced except in unusual circumstances when it comes to changes in accounting periods and methods. As a result, taxpayers must generally request the written consent of the Commissioner in advance by filing an application on Form 3115, *Application for Change in Accounting Method*, and agreeing to the IRS's terms and conditions for the change in accordance with IRC Section 481(a).<sup>3</sup> Examples of relief obtained under Reg. §301.9100-3 include failing to sign the required Form 3115, and changing accounting methods where the method was available but incorrectly identified on the Form 3115.

### Estate Tax Elections and Portability

While the IRS has been somewhat inconsistent in granting 9100 relief in the gift and estate tax arenas, estate tax portability elections remain one area where practitioners and taxpayers have successfully obtained relief if or when the election deadline was not met. Over the nearly fifty years of its existence, the Estate and Gift Tax unified credit has been increased to the point where it is now the equivalent of \$12,060,000.<sup>4</sup> In the case of married couples, each spouse possesses a unified credit that is currently equivalent to an Applicable Exclusion Amount of \$12,060,000. It previously operated on a "use it or lose it" basis: if a spouse died with a taxable estate that was less than the credit equivalent, the unused credit was unavailable to the surviving spouse.

In 2010, however, "portability" of the unused credit between spouses was permitted for the first time under IRC §2010(c).<sup>5</sup> Effective for individuals dying after December 31, 2010, the amount of the unused unified credit of the first spouse to die (i.e., the Deceased Spousal Unused Exclusion (DSUE)) could be "ported" (i.e., carried over) to be applied by the surviving spouse against any taxable gifts made by the surviving spouse or utilized at their subsequent death. The amount of the unified credit was later doubled, thus greatly expanding the potential benefits of portability.

In order for the executor of a deceased taxpayer to transfer the DSUE amount to the surviving spouse, IRC §2010 requires the filing of an "election." The Portability Election can be easily made by completing and timely filing Form 706, *United States Estate (and Generation-Skipping Transfer) Tax Return*.

### Due Date for Making the Portability Election

IRC §2010 appears at first glance to be a black and white rule leaving no latitude for failure to meet the tax filing deadline.<sup>6</sup> However, the deadline for portability elections is set by regulation rather than by statute. IRC §6018(a) requires the filing of Form 706 only when the decedent's gross estate exceeds the Basic Exclusion Amount. When the gross estate is less than the Basic Exclusion Amount, Form 706 is only necessary to make the Portability Election.

Accordingly, Treas. Reg. §20.2010-2(a) sets the due date of filing Form 706 when electing portability at nine months after the date of a decedent's death or the last day of the period covered by an extension, if one was obtained. The regulation goes on to state that an extension of time under §301.9100-3 may be available only to an estate that is under, not over, the filing threshold.<sup>7</sup>

### Extension and Simplification Under Revenue Procedures 2017-34 & 2022-32

The Tax Cuts and Jobs Act of 2017 (TCJA) doubled the amount of the unified credit available to taxpayers, when it doubled the Basic Exclusion Amount \$5,000,000 to \$10,000,000 and added an inflation adjustment. The IRS issued Rev. Proc. 2017-34<sup>8</sup> which granted an automatic two year extension to taxpayers that had not filed Form 706 for decedents because the decedent's gross estate was under Basic Exclusion Amount.

Most recently, the IRS also issued Rev. Proc. 2022-32,<sup>9</sup> which allowed taxpayers to use a simplified method for requesting relief on or before the fifth anniversary of the decedent's death. If the decedent was a U.S. Citizen and no estate tax return was otherwise filed, an executor may file Form 706 and make a late election and by writing the words "Filed Pursuant to Rev. Proc. 2022-32 to elect portability under Sec. 2010(c)(5)(A)" at the top. Relief will be automatically granted without a formal PLR.

To summarize, a late DSUE election can generally be made by filing a Form 706 within five years and nine months of the date of death of the first spouse.

<sup>3</sup> Reg. §1.446(e)(3)(i).

<sup>4</sup> As of Calendar year 2022.

<sup>5</sup> Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312) December 10, 2010.

<sup>6</sup> "No election may be mad under this subparagraph if such return is filed after the time prescribed by law (including extension) for filing such return.

<sup>7</sup> The term Basic Exclusion Amount is defined in IRC §2010(c)(3).

<sup>8</sup> Rev. Proc. 2017-34, I.R.B. 2017-26 (June 9, 2017).

<sup>9</sup> Rev. Proc. 2022-32, I.R.B. 2022-30 (July 8, 2022).

### Action Plan for Making a Streamlined Portability Election

In instances where an executor is filing an estate tax return (Form 706) for a decedent with a gross estate that is below the Applicable Exclusion Amount, the executor is permitted an important short-cut that greatly simplifies the reporting on Form 706. Rather than requiring careful reporting of the fair market value of each and every asset disclosed on the return and attached qualified appraisals, Treas. Reg. §20.2010-2(a)(7)(ii) does not require the executor to report any value for any assets that are deductible under §2056 or §2056A.

Consider implementing the following action plan:

- The information reported on Form 706, pages 1 and 2, remains that same under the simplified method, except for the possible inclusion of the language from Revenue Procedure 2022-32 at the top of the page.
- Form 706, page 3, Part 5 is labeled “Recapitulation” and is a summary of the values of the Gross Estate and Deductions. Since the values of the marital deduction assets will not impact the amount of the unified credit that will be applied on the return, their valuation is in effect unnecessary. As a result, the instructions to Form 706 request only that the executor report an estimated value for the marital deduction assets on line 10.<sup>10</sup>
- On Schedules A through G report only the appraised values of the assets that will not pass under the marital deduction.
- Only attach appraisals for the assets that will not pass under the marital deduction.
- When listing the assets on Schedules A through G that will ultimately pass under the marital deduction, Treas. Reg. §20.2010-2(a)(7)(ii) requests only that the executor report the description, ownership, and/or beneficiary of each asset qualifying for the marital deduction, along with other information necessary to establish that the asset will qualify for the marital deduction
- Form 706, Page 4, Part 6 Section C contains the computation of the Deceased Spouses Unused Exemption (DSUE) amount by using the amount reported on Page 1, Part 2 as its guide.

### Risk Management Tips

Above all, lawyers who find themselves in situations where they or their clients may have missed an election deadline or made certain filing errors must be cognizant of the potential tax consequences for their client, and should consider of potential avenues for 9100 relief.

Where the attorney was not the tax preparer or the person primarily responsible for preparation of the tax return or the filing of the election, the analysis may be an objective exercise. First, assess whether the error resulted an improper filing or a missed tax election deadline. If the error resulted in the latter, evaluate whether Treas. Reg. §301.9100 et seq. is applicable to the client’s circumstances and would cure the error or omission. If you conclude that Regulation §301.9100 et seq. is applicable, determine whether an extension is necessary and whether the extension sought is automatic (under Reg. §301.9100-2) or discretionary (under Reg. §301.9100-3). Ensure that you review the statements, forms, supporting documents, formats, and processes required for the relevant extension, including whether Private Letter Rulings or user fees are necessary, and specific language to include on the requests.

Regardless of any options for relief under Treas. Reg. §301.9100 et seq., if you find yourself in a situation where you’ve made an error by missing an election deadline or making filing errors, it is imperative that you inform your client of the error and get their consent to continue the representation and recommended course of action. Disclosure of errors to the client, particularly material errors, remains the lawyer’s duty despite the applicability of any 9100 relief discussed here. Furthermore, remember that it remains the sole decision of your client to elect to proceed with seeking 9100 relief and whether the client continues to engage you as their counsel. In accordance with American Bar Association Model Rule of Professional Conduct (“ABA Rule”) 1.4, lawyers should be thorough in explaining all pertinent details of any material errors to their client, including the factual circumstances surrounding the error and consequences to the client’s legal position in the current matter.

<sup>10</sup> This estimate is only necessary for the purpose of determining whether or not the Total Gross Estate was above or below the Basic Exclusion Amount for the purposes of IRC §6018(a). As discussed above, if the value of the Gross Estate is greater than the Applicable Exclusion Amount, then the Portability Election must be claimed on a timely filed return and a late election under Revenue Procedure 2022-32 will not be available

Equally important is ensuring that the lawyer undertakes of a conflict of interest review. Under ABA Rule 1.7(a)(2), lawyers are prohibited from representing clients when there exists a significant risk that such representation may be materially limited by the personal interests of the lawyer. A practitioner who attempts to hide a mistake, such as a missed deadline for a tax election that was attributed to the lawyers own actions (rather than a delay or omission by the client) and pursues one of the avenues of relief under Treas. Reg. §301.9100 et seq. without notifying and/or obtaining authority from the client to do so may risk creating and/or exacerbating a personal conflict of interest by subordinating their client's interests to their own personal interests.

In general, the risk that a lawyer will face a substantial malpractice claim due to their error increases the likelihood that the lawyer's personal interest and ability to provide impartial advice will be compromised, resulting in a materially limited representation. However, under Model Rule 1.7(b), if the attorney "reasonably believes that [he or she] will be able to provide competent and diligent representation" to the affected client, among other conditions, the lawyer may continue their representation. A lawyer who concludes that they may continue their representation must nonetheless obtain the client's written informed consent to do so and waive the conflict.

Lastly, if you find yourself in this situation, you should ensure that you meet any reporting obligation of the error or omission to your legal malpractice carrier.

### Summary

Tax laws and regulations can often appear to be daunting, and even experienced professionals may make mistakes at times when it comes to meeting compliance deadlines and making tax elections. Nonetheless, there are numerous opportunities under §301.9100 et seq. in the income tax, gift tax and estate tax arenas to correct errors and make late elections. If you find yourself or a client in a situation where a tax election or filing deadline may have been missed, remember all is not lost. Life is full of second chances, if you look for them.

### This article was authored for the benefit of CNA by:

#### Leynee Flores and Brian T. Whitlock

Leynee Flores, JD, is a partner with Golan Christie Taglia, LLP.

Brian T. Whitlock, CPA, J.D., LL.M., is Of Counsel with Golan Christie Taglia, LLP. He is also an adjunct member of the faculty in the Northwestern University -Pritzker School of Law.

For more information, please call us at 866-262-0540 or email us at [lawyersrisk@cna.com](mailto:lawyersrisk@cna.com)