

Instructions for Form 706-A

(Rev. September 2004)



Department of the Treasury
Internal Revenue Service

United States Additional Estate Tax Return

Section references are to the Internal Revenue Code unless otherwise noted.

General Instructions

Purpose of Form

An heir must use Form 706-A to report the additional estate tax imposed by section 2032A(c) for an early disposition of specially valued property or for an early cessation of a qualified use of specially valued property.

The recapture tax is limited to the tax savings attributable to the property actually disposed of (or for which qualified use ceased) rather than to the tax savings attributable to all the specially valued property received by the heir.

Who Must File

The qualified heir must file Form 706-A if there was any "taxable event" (as defined below) with respect to the specially valued property even if no tax is ultimately due. Further, the qualified heir must file Form 706-A if there was any involuntary conversion or exchange of the specially valued property even if the conversion or exchange is nontaxable.

When To File and Pay

File Form 706-A and pay any additional taxes due within 6 months after the taxable disposition or cessation of the qualified use unless an extension of time has been granted.

Use Form 4768, Application for Extension of Time to File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes, to apply for an extension of time to file. Circle "Form 706-A" at the top of Form 4768.

Make the check or money order payable to the United States Treasury and write the qualified heir's social security number on the check or money order.

If you are making an election to increase basis, see *Basis*, on page 2 for information on paying interest.

Where To File

File Form 706-A with the Internal Revenue Service Center listed below.

If the decedent was at death a...
U.S. citizen residing in the U.S. or a
resident alien, then:
Internal Revenue Service Center
Cincinnati, OH 45999

If the decedent was at death a...
Nonresident U.S. citizen, then:
Internal Revenue Service Center
Philadelphia, PA 19255

Statute of Limitations

The additional estate tax may be assessed until 3 years after the IRS receives notice that the qualified heir disposed of the specially valued property or ceased to use it for the qualified use.

However, if the property was disposed of in an involuntary conversion or in an exchange, the tax may be assessed up to 3 years after the IRS receives notice that the property was replaced or will not be replaced. See section 2032A(f).

Lien

If the estate elected special use valuation, section 6324B establishes a special lien against the specially valued property equal to the adjusted tax difference attributable to the special use valuation.

Definitions

Specially valued property. The term "specially valued property" means farm or closely held business property that the executor elected to value at actual use rather than fair market value. The executor makes the election on Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, filed for the decedent. Specially valued property refers to the qualified real property described in section 2032A and includes qualified real property owned indirectly, such as interests in certain partnerships, corporations, and trusts as described in section 2032A. If special valuation was

elected on Form 706, each qualified heir consented in writing to his or her personal liability for the additional estate tax attributable to his or her interest in the specially valued property.

Qualified heir. The term "qualified heir" means, for any property, a member of the decedent's family who acquired the property (or to whom the property passes) from the decedent. If a qualified heir disposes of any interest in qualified real property to any member of his or her family, that member shall thereafter be treated as the qualified heir for the interest.

Taxable Events

The qualified heir causes a taxable event by disposing of any interest in the specially valued property or ceasing to use the specially valued property for its qualified use if:

- The disposition or cessation of qualified use was before the death of the qualified heir, and
- The disposition or cessation was within 10 years after the decedent's death (But see *Two-Year Grace Period* on page 2.)

Only one additional estate tax will be imposed with respect to any one part of specially valued property. For example, if additional estate tax is imposed for early cessation of a qualified use, a second additional estate tax will not be imposed for a subsequent early disposition of the same part of the specially valued property.

Disposition to family member. A disposition of an interest in property to a family member of the qualified heir is a "taxable event" that must be reported on Form 706-A. If the transferee enters into an agreement to be personally liable for any additional tax under section 2032A(c), the disposition is nontaxable and you should enter it on Schedule C.

If the family member does not enter into the agreement, the disposition is taxable and you should enter it on Schedule A.

Disposition of timber. If the executor made a qualified woodlands

election (section 2032A(e)(13)(A)), the disposition or severing of timber from the woodland is a disposition of a portion of the interest in the property. The disposition of a right to sever is treated as a disposition of the standing timber.

The additional estate tax on this disposition is the amount equal to the lesser of:

- The amount realized on the disposition (or, if other than a sale or exchange at arm's length, the fair market value of the interest disposed of), or
- The amount of additional estate tax that would have been imposed if the entire interest of the qualified heir in the qualified woodland had been disposed of, minus any additional estate tax imposed on all earlier transactions involving the woodland.

Cessation of qualified use. The specially valued real property must be used as a farm for farming purposes, or used in a trade or business other than the trade or business of farming. For more details, see the Instructions for Form 706.

The qualified use ceases if the specially valued real property is not used for the qualified use described above. Use of the property as a farm or other business is also considered to cease if, during any 8-year period that ends after the decedent's death, there were periods totaling more than 3 years during which:

1. Neither the decedent nor any member of the decedent's family materially participated in the operation of the farm or other business (while the decedent held the property), and
2. Neither the qualified heir nor any member of the qualified heir's family materially participated in the operation of the farm or other business (while the heir held the property).

If the decedent was retired or disabled before death, there are special rules for applying the 8-year period to paragraph (1) above. See section 2032A(b)(4) and the Instructions for Form 706.

Member of family. The term "member of the family" includes only:

- An ancestor (parent, grandparent, etc.) of the individual (where individual refers to either the decedent or a qualified heir);
- The spouse of the individual;
- A lineal descendant (child, stepchild, grandchild, etc.) of the

individual, the individual's spouse, or a parent of the individual; or

- The spouse, widow, or widower of any lineal descendant described above.

A legally adopted child of an individual is treated as a child of that individual by blood.

Period of material participation. To determine whether the material participation requirement is satisfied, include periods during which the decedent's estate held the property.

If a qualified heir dies before the required period has passed, any material participation requirement ends for that heir's portion of the property, provided the heir received a separate or other undivided interest from the decedent.

If qualified heirs receive successive interests in specially valued property (e.g., a life estate and remainder interests), the material participation requirement does not end for any part of the property until the later of the expiration of the recapture period or the death of the last qualified heir.

In determining whether the required participation has occurred, disregard brief periods (30 days or less) during which there was no material participation. But you may disregard these periods only if they were both preceded and followed by substantial periods (more than 120 days) in which there was uninterrupted material participation.

Required activities for material participation. See the Instructions for Form 706.

Basis

See section 1014(a) for the basis of property acquired from a decedent.

Election to increase basis. A qualified heir may elect to increase the basis of specially valued property when a taxable event (as defined on page 1) occurs. If this election is made, the basis of the property shall increase to the excess of the fair market value (FMV) amount on the decedent's date of death (or alternate valuation date, if applicable) over the value amount determined under section 2032A. Once the election is made, it is irrevocable.

To make the election, a qualified heir must file with Form 706-A, a statement that:

- Contains the name, address, and taxpayer identification number of the qualified heir and of the estate;

- Identifies the election as the election under section 1016(c) of the Code; and
- Specifies the property with respect to which the election is made.

A qualified heir who makes this election must pay interest on the additional estate tax calculated from the date that is nine months after the date of the decedent's death to the date of the payment of the additional estate tax.

TIP *When paying interest on the additional estate tax due, identify and enter the amount of interest you are paying in the bottom margin on page 1 of Form 706-A with a notation "section 1016(c) interest." Do not include the interest on line 19.*

Two-Year Grace Period:

Commencement Date

For the 2 years immediately following the date of the decedent's death, the failure by the qualified heir to begin using the property in a qualified use will not be considered a cessation of qualified use and therefore will not trigger the additional estate tax. The date on which the qualified heir begins to use the property in a qualified use is the "commencement date."

The 10-year recapture period is extended by the period after the decedent's death and before the commencement date.

For example, if the decedent died February 28, 1993, and the commencement date is August 1, 1994, the recapture period would begin August 1, 1994, and end July 31, 2004.

How To Complete Form 706-A

You may only file Form 706-A for one qualified heir. If a disposition, cessation, involuntary conversion, or exchange involves more than one qualified heir, each heir must file a separate Form 706-A.

Complete Form 706-A in this order:

1. Part I,
2. Schedules A and B,
3. Part II,
4. Schedule C.

The qualified heir must sign the return.

Specific Instructions

Valuation

When computing the amounts to enter on Form 706-A, use the same values and estate tax that the executor reported on the Form 706 filed for the decedent. However, if the IRS has completed the audit of the estate tax return, use the agreed values and tax rather than the reported values and tax.

Schedule A

On Schedule A list every specially valued property interest that the qualified heir disposed of or discontinued use of since the date of the decedent's death and for which a Form 706-A has not been previously filed. Do not list any interests that have already been reported on Schedule A or B of a previously filed Form 706-A. In general, do not list property interests disposed of to family members of the qualified heir. These interests should be listed on Schedule C.

Column A. Within each part, list and number the property interests in chronological order of disposition or cessation.

Column B. Use the same description in column B that the executor used for the specially valued property on the Form 706 filed for the decedent. Please include in column B the schedule and item number where the specially valued property was reported on the Form 706 filed for the decedent's estate.

Column C. Report in column C the date that the qualified heir disposed of the specially valued property or discontinued the qualified use.

Column D. If the qualified heir disposed of the specially valued property in an arm's length transaction, report in column D the amount realized.

An "arm's length transaction" is a transaction where there is no bargain or gift element for affection or other reasons.

The amount realized is the sum of the money received plus the fair market value of property (other than money) received. For the real property taxes that must be taken into account, see section 1001(b).

If the qualified heir owned only a part of the specially valued property, report in column D the *pro rata* share of the amount realized that is

allocable to the part owned by the qualified heir.

If the specially valued property is disposed of by the qualified heir in other than an arm's length transaction, or if the qualified use is discontinued by the qualified heir, report in column D the fair market value of the specially valued property as of the date of disposition or cessation of qualified use.

Fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts.

For additional information and examples, see Regulations section 20.2031-1(b). If the qualified heir owned only a part of the specially valued property, report in column D the *pro rata* share of the fair market value allocable to the part owned by the qualified heir.

Column E. Report in column E the special use value at the date of the decedent's death (or alternate valuation date) of the specially valued property that passed from the decedent to the qualified heir who disposed of the property or discontinued the qualified use. Use the same special use value that the executor reported on the Form 706 filed for the decedent's estate. If the IRS has completed the audit of the estate tax return, use the agreed value rather than the reported value. If the qualified heir owned only a part of the specially valued property, report in column E the *pro rata* share of the special use value allocable to the part owned by the qualified heir.

Schedule B—Involuntary Conversions or Exchanges

Involuntary conversions of qualified real property (under the rules of section 1033) and exchanges of qualified real property (under the rules of section 1031) are treated similarly when computing the additional estate tax on Form 706-A.

The rules below apply to all qualified heirs, whether or not they made an election, for involuntary conversions and exchanges occurring after 1981.

If you are reporting an involuntary conversion or exchange, you may not use the same Form 706-A to report any cessations or other dispositions

that are not involuntary conversions or exchanges. Use a separate Form 706-A for the cessations or other dispositions.

You may report conversions and exchanges together on the same return.

Nontaxable Involuntary Conversions or Exchanges

If the qualified heir reinvests all of the involuntary conversion proceeds in qualified replacement property or if the qualified heir exchanges qualified real property solely for qualified exchange property, then there is no additional estate tax.

You should complete Form 706-A, even though there is no tax, to notify the IRS that the involuntary conversion or exchange took place. However, you must complete only Part I, Schedule B, and Schedule A. Write "nontaxable" on line 19 of Part II.

Partially Taxable Involuntary Conversions or Exchanges

If the cost of the qualified replacement property is less than the amount realized in the involuntary conversion or if other property in addition to qualified exchange property is received in the exchange, the conversion or exchange is partially taxable. You should complete all of Form 706-A and determine the tax using Part II.

List on Schedule A all specially valued property that the qualified heir disposed of or discontinued use of, regardless of whether he or she received replacement or exchange property for it. List on Schedule B only the replacement or exchange property the qualified heir actually received.

Qualified Replacement or Exchange Property

Qualified replacement property means any real property that is to be used for the qualified use and that:

- Was purchased by the qualified heir within the time specified by section 1033 to replace the qualified property, or
- Is real property into which the qualified real property has been converted.

Qualified exchange property means any real property that is to be used for the same qualified use that the property for which it was exchanged was used.

The period of the decedent's or family member's ownership, qualified use, or material participation with respect to replaced or exchanged property is treated as the period of ownership, qualified use, or material participation with respect to the qualified replacement or exchange property. This applies only to that part of the fair market value of the replacement or exchange property (at the date of acquisition) that does not exceed the fair market value of the replaced or exchanged property (at the date of disposition).

Note that the 10-year recapture period is extended under certain circumstances.

How To Complete Schedule B

Column A. Make one entry for each item of qualified replacement or exchange property.

Column B. Describe the qualified replacement property with enough detail so that the IRS can locate and value it. For more information, see the instructions to Schedule A of Form 706.

Column C. For an involuntary conversion, enter the cost of the replacement property. For an exchange, enter the fair market value of the replacement property.

Part II—Tax Computation

Line 2

Enter the total value at the estate tax valuation date of all specially valued property that the executor elected, on the Form 706 filed for the decedent's estate, to value at actual use rather than fair market value.

Line 3a

Enter the amount of the estate tax for the decedent's estate that is recomputed using fair market value at the estate tax valuation date rather than actual use value. Attach a schedule showing the recomputed estate tax.

Schedule C— Dispositions to Family Members of the Qualified Heir

Agreement by Transferee

You may enter a disposition to a family member of the qualified heir on Schedule C only if you file this Form 706-A on time (including extensions) and attach an agreement by the transferee to be personally liable for any additional estate tax under section 2032A(c) on the interest received. For a format of the agreement, see Form 706, Schedule A-1.

If you are not filing this Form 706-A on time, or if the transferee does not enter into the agreement, you must enter the disposition(s) on Schedule A instead of Schedule C.

How To Complete the Schedule

See the instructions for completing columns A, B, and C of Schedule A, beginning on page 3.

Privacy Act and Paperwork

Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. We need it to figure and collect the right amount of tax. Subtitle B, Estate and Gift Taxes, of the Internal Revenue Code, imposes a tax in some cases on qualified heirs who dispose of property valued under special valuation rules. This form is used to determine the amount of the taxes that you owe. Section 6011 requires you to provide the requested information if the tax is applicable to you. Section 6109 requires you to provide your taxpayer identification number (SSN).

Routine uses of this information include giving it to the Department of Justice for civil and criminal litigation, and to cities, states, and the District

of Columbia for use in administering their tax laws. We may also disclose this information to other countries under a tax treaty, or to federal and state agencies to enforce federal nontax criminal laws and to combat terrorism. The authority to disclose information to combat terrorism expired on December 31, 2003. Legislation is pending that would reinstate this authority. If you fail to provide this information in a timely manner, you may be subject to penalties and interest.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is:

| | |
|---|----------------|
| Recordkeeping | 3 hr., 17 min. |
| Learning about the law or the form | 2 hr., 11 min. |
| Preparing the form | 1 hr., 39 min. |
| Copying, assembling, and sending the form to the IRS | 1 hr., 3 min. |

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can write to the Internal Revenue Service, Tax Products Coordinating Committee, SE:W:CAR:MP:T:T:SP, 1111 Constitution Avenue, NW, Washington, DC 20224. Do not send the tax form to this office. Instead, see *Where To File* on page 1.
