

Instructions for Form 706-A



Department of the Treasury
Internal Revenue Service

(Rev. November 2006)

United States Additional Estate Tax Return

to report disposition or cessation of qualified use on Form 706-A of the Internal Revenue Code

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

What's New

- The qualified heir must now file Form 706-A at the Central Service Center, regardless of whether the decedent was a U.S. citizen residing in the U.S. at death and/or a nonresident U.S. citizen. See *When To File* below for the address.
- You can apply for an automatic 6-month extension of time to file Form 706-A by filing Form 4768, Application for Extension of Time to File a Return and/or Pay U.S. Estate and Generation-Skipping Transfer Taxes (Rev. January 2005). When asking for an automatic 6-month extension, you are not required to provide an explanation for your request. See Form 4768 for more details.

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 receding 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 (see *Taxable Events* 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 90 days after the taxable disposition or cessation of the qualified use. The 90-day extension of time has been in effect.

Use Form 4768 to apply for an automatic extension of time to file. Check the Form 706-A box in Part II of Form 4768.

Make the check or money order payable to the "United States Treasury" and write "Form 706-A" and 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 following address:

Internal Revenue Service Center
Cincinnati, OH 45209

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 an exchange, the tax may be assessed up to 3 years after the IRS receives notice that the property was disposed of or will not be replaced (see section 2032A(f) for details).

Lien

If the estate elected special-use valuation, section 6321B establishes a special lien against the specially valued property equal to the additional 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, that 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 that 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— Commencement Date* 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 use lands election (see Form 706-A(1)(b)(ii)), the disposition of the timber of timber from the woodland in the disposition of a portion of the tract of land the property. The disposition of the timber is treated as if it is a sale of the standing timber.

The amount of estate tax on this disposition will be equal to the lesser of:

- The amount reported on the disposition, other than a sale or exchange at arms' length, the fair market value of the interest disposed of; or
- The amount of a federal 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 a similar transaction 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 purposes 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 (such as) considered to cease if, during any 2-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 3-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 minor 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 individual decedent described above.

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

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 takes care of the required period the period ends, any material participation requirement ends for that heir's portion of the property, provide if the heir received it separate or other individual interest from the decedent.

If qualified heirs receive successive interests in specially valued property (for example, a life estate and remainder interests), the material participation requirement does not end for any part of the property until the date of the expiration of the recapture period of the last 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. If you may disregard these periods, only if they were both preceded and followed by substantial periods (more than 120 days) in which there was use of the 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 (as defined on page 3) 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 it is filed, beginning after the date of the decedent's death to the date of the payment of the additional estate tax.



What to pay interest on the additional estate tax due, identify, and enter the amount of interest you are paying in the bottom quarter of page 1 of Form 706-A with a note to section 2032A 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 23, 2003, and the commencement date is August 1, 2004, the recapture period would begin August 1, 2004, and end July 31, 2014.

How To Complete Form 706-A

You may 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.

Note. 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. Disposition of Specially Valued Property or Cessation of Qualified Use

On Schedule A, list every specially valued property interest that the qualified heir has disposed of or discontinued as of a date 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, discontinue property interests disposed of to family members of the qualified heir. These interests should be listed on Schedule C.

Column A. Select and list the property interests in chronological order of disposition or cessation.

Column B. List the same description in column B that the executor used for the special-use valued property on the Form 706 filed for the decedent. Please include in column B the schedule and item number from the specially valued property return filed for 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 this qualified heir disposed of the specially valued property in an arm's length transaction, report in column D the amount realized.

Arm's length transaction. An *arm's length transaction* is a transaction where there is no bargain or gift element by either or other reasons.

Amount realized. 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 to 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. *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 20.2037-1(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. If the decedent 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 conversions or other dispositions that are not involuntary conversions or exchanges. Use a separate Form 706-A for the conversions 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 III.

Partially Taxable Involuntary Conversions or Exchanges

If the part of the qualified replacement property (plus, if the amount realized in the involuntary conversion or if the property is added to qualified exchange property) is received in the exchange, the conversion or exchange is partly taxable. You should complete Form 706-A and determine the tax using Part II.

List on Schedule A all specially valued property that the qualified heir disposed of and introduced 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 that the 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 for when the qualified property is
- Taken and placed 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. The 10-year recapture period is extended under certain circumstances. See *10-Year Grace Period—Qualified Replacement Date* on page 2.

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 details 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 inventory only transfer, 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 amount for estate tax valuation. This total includes valued property that is exempt (reported on the Form 706) from the decedent's estate tax or, 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 by a family member of the qualified heir only if you file this Form with Schedule 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 a beneficiary filing this Form 706-A on behalf of the transferee does not enter into the agreement, you must enter the disposition(s) on Schedule A instead of Schedule C.

How To Complete Schedule C

See the instructions for completing column C, 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 6101 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).

Generally, tax returns and return information are confidential, as required by section 6103. However, section 6101 allows or requires the Internal Revenue Service to disclose or give such information shown on your Form 706-A to the Department of Justice to enforce the tax laws. Both civil and criminal and, in times, states, the District of Columbia, U.S. commonwealths or possessions, and certain foreign governments for use in administering their tax laws. We may also disclose this information to other

countries under a tax treaty, to federal or tax criminal laws, or to federal law enforcement and intelligence agencies to combat terrorism. 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 that its instructions may require to be kept as their basis for the reporting as their duty may be required in the administration of any Internal Revenue law.

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

Recordkeeping	2 hr. 17 min.
Learning about the law or the form	2 hr. 17 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 Development Committee, SELF-CARE UNIT, SP, 1111 Constitution Ave. NW, IR 6406, Washington, DC 20224. Do not send the tax form to this office. Instead, see *Agreement A-1* on page 1.