Confusion Over Income Tax Basis for Deaths in 2010

-by Neil E. Harl

The allegedly vague and confusing provisions in the Economic Growth and Tax Relief Reconciliation Act of 2001 have succeeded in raising questions about effects of the enactments on the income tax basis of assets included in the gross estate for deaths in 2010. The provisions have produced questions as to what was intended by the Congressional drafters and how the provisions should be interpreted. As has been widely observed, no one believed in 2001 that the federal estate tax and generation-skipping transfer tax would be repealed after 2009 but would reappear one year later. That probably accounts for at least part of the confusion currently over the income tax basis applicable to property held by a decedent at the time of death in 2010.

Of course, Congress could yet enact legislation in 2010 that would nullify some of the provisions and essentially continue the income tax basis regimen in place for deaths through December 31, 2009, for deaths in 2010. On the other hand, the Congress could do nothing or could make the repeal enacted in 2001 permanent.

Quick review of rules in effect through 2009

For deaths through December 31, 2009, the rules for determining the income tax basis of assets held at death were relatively clear. Through 2009, “... the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent shall, if not sold, exchanged or otherwise disposed of before the decedent’s death by such person, be — (1) the fair market value of the property at the date of the decedent’s death, (2) in the case of an election under . . . section 2032 [alternate valuation] . . . of the Internal Revenue Code . . . its value at the applicable valuation date prescribed . . ., (3) in the case of an election under section 2032A [special use valuation], its value determined under such section, or (4) to the extent of the applicability of the exclusion described in section 2031(c), [land subject to a qualified conservation easement] the basis in the hands of the decedent.” Thus, other than for the exceptions noted, fair market value at death is the test.

Rules for determining basis after 2009

Property of a decedent dying after December 31, 2009, is treated as transferred by gift and the basis of the person acquiring property from such a decedent is the lesser of — (A) the adjusted basis of the decedent, or (B) the fair market value of the property at the date of the decedent’s death. There are, of course, adjustments authorized to the decedent’s adjusted basis (the aggregate basis increase of $1,300,000, the increase for “qualified spousal property” of up to $3,000,000, the adjustment for built-in losses and loss carryovers, and the adjustment for decedent non-residents of the United States of $60,000)

EGTRRA in Section 901 provides for a “sunsetting” of all provisions in the 2001 Act (including I.R.C. § 1022) — “All provisions of and amendments made by this Act shall not apply — (2) . . . .to estates of decedents dying, gifts made, or generation skipping transfers, after December 31, 2010.” Some have argued that somehow, for deaths in 2010, the heirs will still retain a fair market value basis if the inherited assets are sold after 2010. That is not what the statute states. To repeat, the statute merely states that “... this Act shall not apply . . . . to estates of decedents dying . . . after December 31, 2010.” The sunset provision says nothing about the sale of assets in 2011 or later. Neither the statute nor the sunset provision says anything about the basis of decedents dying in 2010 being entitled to a step-up (or down) in basis in 2011. The statute merely states that the various Act provisions will not apply to deaths after December 31, 2010. There is a lack of credible authority for arguing that, for a death in 2010, the property is entitled to a new basis if the assets are held until 2011 or later.

Rules for determining basis for deaths after 2010

Assuming that Congress restores the concept of a new basis at death (or allows the current law to continue), property held by decedents dying after 2010 will be entitled to a new basis at death (stepped up or down) under the rules of I.R.C. § 1014(a). Congressional action to restore carryover basis after 2010 would require enactment or reenactment of carryover basis rules because the rules in EGTRRA will not be effective in 2011 and later years without further action by the Congress.

ENDNOTES


5 I.R.C. § 1022(a)(1).

6 I.R.C. § 1022(a)(2).

8 I.R.C. § 1022(c).
9 I.R.C. § 1022(b)(2)(C).
10 I.R.C. § 1022(b)(3).

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