CPAs & Advisors

Opportunity in Numbers

Guide to Inherited Property "Basis" Rules

Guide to Inherited Property "Basis" Rules

How do you determine the tax basis of inherited property?

If you have inherited property, it can be a bit confusing to determine what "cost" for tax purposes (or "basis") an individual has in the inherited property. It is crucial for the fair market value basis rules to be understood to avoid disastrous tax errors.

With that in mind, this guide should be a helpful summary of the rules and regulations regarding fair market basis rules. **Please note: the rules discussed below apply to deaths during calendar years other than 2010.** The tax professionals at MRPR can help you understand the specific rules applicable to deaths that occurred during 2010.

The Fair Market Value Basis Rules: Step-Up or Step-Down?

Under fair market value basis rules, a person inheriting property (an heir) receives a "basis" in inherited property equal to its **date of death value**.

Step-Up in Basis

For example, if Uncle Harry bought General Electric stock in 1935 for $500 and it's worth $5 million at this death, the basis is **stepped up** to $5 million in the hands of his heirs and all of the gain prior to Uncle Harry's death **escapes taxation forever**.

Alternatively, if, in the above example, Uncle Harry, instead of dying owning the stock, decided to make a gift of it in honor of his 100th birthday, the "step-up" in basis (from $500 to $5 million) would be lost. Property that has increased in value acquired by gift is subject to the "carryover" basis rules: the donee takes the same basis the donor had in it (just $500), plus a portion of any gift tax the donor pays on the gift.

Step-Down in Basis

A **step-down** occurs if a decedent dies owning property that has declined in value. In that case, the basis is lowered to the date of death value. A step-down calls for proper planning to avoid this loss of basis.

Giving the property away before death will not preserve the basis when property which has gone down in value is the subject of a gift. The recipient must take the date of gift value as his tax basis. In this case, the best idea for property which has declined in value would be for the owner to sell the property before his death so he may enjoy the tax benefits of the loss.

This is an example where talking to a tax expert before a transaction has occurred may result in significant tax savings down the road. The tax professionals at MRPR can help you understand the step-up basis or step-down basis consequences of a property transfer to maximize your tax savings.

To What Do the Fair Market Basis Rules Apply?

The fair market value basis rules apply to inherited property that's includible in the deceased's gross estate, whether or not a federal estate return was filed. Those rules also apply to property inherited from foreign persons, who aren't subject to U.S. estate tax.

The rules apply to the inherited portion of property owned by the inheriting taxpayer jointly with the deceased, but not the portion of jointly held property that the inheriting taxpayer owned before his inheritance.

The fair market value basis rules also do not apply to reinvestments of estate assets by fiduciaries.

Other Factors to Consider

There are other factors to consider in relation to inherited property, including:

Alternate Valuation

Although this discussion refers to date of death value, the value is different in some cases. If the decedent's executor makes the alternate valuation election, then basis will be determined as of the date six months after the date of death (or, if the property is distributed by the estate within the six month period, the date of distribution or other disposition).

Death Bed Maneuvers

A device considered by some taxpayers is to pass property to an older person, in an attempt to inflate basis under
the fair market value basis rules. For example, say Tim owns stock with a $1,000 basis and $20,000 value. He goes to 97-year old Uncle Vern and arranges the following: Tim makes a gift of the stock to Uncle Vern, who takes it with Tim's $1,000 basis. Vern then dies, leaving the stock back to Tim in his will. Tim regains ownership, but now with the basis stepped up to its $20,000 date of death value. However, under a rule to prevent this result, if Uncle Vern dies within a year of when Tim made the gift, Tim still has his original ($1,000) basis.

It is important to consult with a tax expert before any moves are made related to inherited property.

The tax experts at MRPR can help you with matters related to inherited property. If you have any questions related to inherited basis rules, please contact:

Cheryl Gill
248.415.4408
clgill@mrpr.com