Stepped-up basis From Wikipedia, the free encyclopedia

- **Stepped-up basis** is the term used to describe the basis of property that a taxpayer receives from a decedent under the Internal Revenue Code § 1014(a).

General rule - Under IRC § 1014(a) the general rule applied to property a beneficiary receives from a benefactor is that the beneficiary's basis equals the fair market value of the property at the time the decedent dies. For example, Decedent owns a home she originally purchased for $35,000. Her basis in the home is equal to its cost, $35,000, assuming no adjustments under IRC § 1016. On the day Decedent dies, the fair market value of the home is $200,000. If Decedent bequeaths the home to Beneficiary, Beneficiary's basis in the home will be the fair market value, $200,000. In contrast, had Decedent given the home to Beneficiary before her death, Beneficiary would receive a carryover basis, which would be equal to the decedent's adjusted basis in the home, $35,000.[1]

Stepped-down basis - Likewise, under § 1014(a), if a decedent's adjusted basis in property is higher than the fair market value, the beneficiary's basis will equal the fair market value of the property at the time the decedent dies. For example, Decedent owns a yacht whose adjusted basis is $150,000, but at the time of her death, the fair market value of the yacht is only $110,000. The beneficiary's basis in the yacht will be the fair market value, $110,000.

Incentive for Taxpayers - Because of this provision, any appreciation of the affected property that occurred during the decedent's lifetime will never be taxed. Thus, this provision provides an incentive for taxpayers to retain appreciated property until death and sell depreciated property while they are alive.

§ 2032 Election for Alternate Valuation - Section 2032 provides an alternate method of determining the property's new basis. If the property is not disposed of within six months of the decedent's death, the executor may elect to use the property's fair market value six months after the date of death. If the executor does not so elect, or if the property is disposed of before the six months have passed, then the property will still assume a basis equal to its fair market value at the time of death.

Definitions - "Property acquired from the decedent" under IRC § 1014(b) generally includes property acquired by bequest, devise or inheritance, property the decedent gives to his or her estate, and certain revocable trusts.[2]

Rationale for stepped-up basis

One possible explanation for the stepped-up basis rule under IRC § 1014 is to avoid the difficulty of ascertaining a decedent's adjusted basis in property that could have been held for decades.[3] A second theory is that a decedent is not likely trying to evade taxes by passing property at death, so mandating carryover basis, which would preserve the gain in the beneficiary, is unnecessary.[4] Third, the federal government imposes estate taxes on transfers of wealth at death based on those assets values as of that date.[5] Were no step up in basis allowed, the federal government could potentially receive a windfall from estates subject to estate tax by recovering federal estate tax based on capital assets' values as of a decedent's date of death, while also receiving capital gains tax when such assets are sold by an estate or a beneficiary based on the difference between the value of the asset when sold and the price at which such asset was purchased by a decedent.