

1. **Fundamentals Program: Planning for Income Tax Basis by Lester Law and Howard Zartisky.**

a. Changing planning paradigm.

i. \$12M estate used to be viewed as a large estate, and it would have faced a substantial estate tax. Now, however, the estate tax will be negligible, but the potential income tax impact much more dramatic. This makes the need to plan for basis step-up far more important for most estates than to plan for the reduction of estate tax.

ii. For wealthier clients basis step up must be maximized as well as estate tax reduction planned for.

b. While cost basis is commonly referred to for income tax purposes there are a myriad of definitions and nuances to consider. The impact of whether there is an exchange, or other type of transfer may affect which basis rules apply. As another example, in the year 2010 the odd rules for basis applied. IRC Sec. 1022.

c. What is basis?

i. What the tax law defines as basis may not be identical to a layperson's definition of the investment in a property. It is not what you invest since if you build a home your labor is not factored in as part of basis although it is clearly a valuable investment.

ii. Basis is used to determine gain and loss on disposition.

iii. There are a myriad of technically defined terms with respect to basis.

iv. Basis can be adjusted up and down when you make additions (e.g., subsequent contributions).

1. Interest and taxes on unproductive and unimproved real property as carrying charges, which are normally viewed as deductions, IRC Sec. 266 permits an election to add these as part of income basis.

a. Comment: *"No deduction shall be allowed for amounts paid or accrued for such taxes and carrying charges as, under regulations prescribed by the Secretary, are chargeable to capital account with respect to property, if the taxpayer elects, in accordance with such regulations, to treat such taxes or charges as so chargeable."*

2. Under Regulations refers to an original tax return. Therefore, this cannot be done retroactively on an amended return.

v. There can be deletions or reductions to basis from depreciation, amortization, etc.

1. Now use MACRS as the depreciation calculation (prior law was ACRS) depreciation standards. IRC Sec. 168.

d. Basis of property acquired by gift.

i. The basis of property received as a gift is determined under IRC Sec. 1015.

ii. If acquired by gift after 1920 when rules enacted the basis of the donee is generally the same as the basis was in the hands of the donor (the last donor who did not receive the property by gift).

1. Comment: *"If the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift, except that if such basis (adjusted for the period before the date of the gift as provided in section 1016) is greater than the fair market value of the property at the time of the gift, then for the purpose of determining loss the basis shall be such fair market value."*

iii. Different basis used if it is a gift of appreciated (fair market value is greater than basis) or depreciated (fair market value less than basis) property. The character may be different than anticipated because of partnership or other adjustments.

iv. The above calculation as to whether the fair market value of the property is less than, or more than, the basis at the date of the gift requires a determination of the effective date of the gift. This is determined under IRC Sec. 2511 and is when the donor relinquishes dominion and control under the gift tax rules. Compare the donor's tax basis to the fair market value on that date.

v. Three scenarios:

1. Donee can sell for more than basis. Use the donor's adjusted basis for determining gain.
2. Donee sells the asset at a price that is between the donor's adjusted basis and the fair market value of the

date of the gift. No gain or loss is recognized in this instance when "in between."

3. The donee sells the property for less than then the lower of: (i) fair market value at the date of gift, (ii) and the carry over basis amount. Loss can be recognized.

vi. Be certain on gift tax returns Form 709 that basis is disclosed. Often this is not done because clients do not have the data or simply do not provide the information.

vii. Gift tax paid may affect basis.

1. The donee's tax basis in the gifted property is increased for the gift tax paid on the gift transfer.
2. This basis adjustment applies regardless of whether it is the donor or donee who pays the gift tax.
3. If you paid gift taxes on the net appreciation of the property given 1015(d)(6) you must determine gift tax allocable to the net appreciation of the asset given away.
4. This basis adjustment appears to be added on as the gift tax is paid. However, if the gift property is sold by the donee before the donor actually pays the gift tax it appears that you can presume that the tax will be paid and so the basis should be increased.

Comment: "(6) Special rule for gifts made after December 31, 1976 (A) In general In the case of any gift made after December 31, 1976, the increase in basis provided by this subsection with respect to any gift for the gift tax paid under chapter 12 shall be an amount (not in excess of the amount of tax so paid) which bears the same ratio to the amount of tax so paid as- (i) the net appreciation in value of the gift, bears to (ii) the amount of the gift. (B) Net appreciation. For purposes of paragraph (1), the net appreciation in value of any gift is the amount by which the fair market value of the gift exceeds the donor's adjusted basis immediately before the gift.