

## Tax Letter

### Federal only: Basis for Property received from Estate of Decedent dying in 2010

As of 1/1/2010, **Federal** estate tax of decedents dying in 2010 has been repealed. So far Congress failed to act upon issues surrounding estate and gift taxes. Therefore, it is safe to assume that there will be no 2010 estate tax and the basis from the estates of decedents dying in 2010 will follow the rule of “**Modified Carryover basis**”.

Surviving spouses and other beneficiaries of 2010 decedents’ estates will not have the benefit and simplicity of the “**Step Up basis**”.

“**Step Up basis**” refers to the rule that all properties in a decedent’s estate, in general, will be valued at the Fair Market Value (FMV) at the time of death. This way, the surviving spouse and other beneficiaries will not be required to trace the old, historical basis or costs of the properties received from a decedent’s estate.

**Carryover basis** is the lesser of (a) the adjusted, historical basis of property in the hands of the decedent and (b) the FMV of the property at the time of death. [ IRC Sec.1022(a) ].

“**Modified Carryover basis**” is the Carryover basis (described above) increased by the allocated amount from the “**General Basis Modifier**” and the “**Spousal Basis Modifier**” but not to exceed the FMV of the property at time of decedent’s death [ IRC Sec.1022(d)(2) ].

( I ) “**General Basis Modifier**” [ IRC Sec. 1022(b) ] refers to the rule that the Carryover basis of the decedent’s property (assuming it is less than the FMV at time of death) to be increased by an amount allocated from the “general basis modifier “ **plus** :

(i) the sum of all capital loss carryover allowed by IRC Sec. 1212(b) and any net operating loss carryover under IRC Sec. 172 which would be allowed to the decedent, and (ii) specific “built-in loss” for specific property in the estate which would have been allowed under IRC Sec.165 to the decedent, if the property had been sold at FMV immediately before the decedent’s death.

The maximum amount allowed as the “general basis modifier” is \$1,300,000. This amount may be allocated to all or to just a selected few properties of the decedent’s estate by the Estate Executor.

**For example:** Assume the adjusted cost basis of property A in the estate is \$50,000 and the FMV at time of death is \$500,000. Since FMV is larger than the cost basis, the cost basis will be the Carryover basis [(IRC Sec. 1022(a)]. Further assume that there is no “specific built-in loss” for this property, and the allocated “general basis modified” plus the allocated IRC Sec.172 loss carryover is \$75,000. The modified basis of Property A at the hands of the beneficiary recipient will be \$125,000 (\$50,000 plus \$75,000) which is smaller than the FMV at the time of decedent’s death.

( II ) **“Spousal Basis Modifier”** [ IRC Sec. 1022(c) ] is an additional aggregate \$3,000,000 allowed to the surviving spouse. This maximum \$3,000,000 may be allocated to all or to just a selected few properties which the surviving spouse received from the decedent’s estate. The allocation of this \$3,000,000 will be determined by the Estate Executor. Since this is an additional aggregate amount allowed to the spouse, therefore, the amount allocated from the “spousal basis modifier” will be added to the basis modified by the “general basis modifier” plus the sum of allocated loss carryover and specific “built-in loss”.

**For example:** Assuming Property A as described earlier is a property having a general modified basis of \$125,000 is a property received by the surviving spouse. Further assume that the amount allocated to Property A from the “spousal basis modifier” is \$300,000. The total basis of Property A in the hands of the surviving spouse will be \$425,000 (\$125,000 plus \$300,000) which is smaller than the FMV at the time of decedent’s death.

( III ) **Allocation of General Basis Modifier and the Spousal Basis Modifier** must be determined and made by the Executor of the Estate. According to IRC Sec. 6018, the Executor must report this allocation on a **“transfers at death”** tax return for any Estate of decedent dying in 2010 with a value in excess of \$1,300,000 and the return must show the following required information:

- a). name and tax payer ID of the beneficiary receiving property,
- b). description of the property,
- c). historical cost basis of the property in the hands of the decedent, it’s FMV, and the holding period at time of death of the decedent,
- d). the amount of basis modification allocated to the property under IRC Sec.1022(b) & Sec.1022(c), namely the General Basis Modifier and the Spousal Basis Modified,
- e). the amount of any carry over losses allowed by IRC Sec.1212(b) and IRC Sec.172(b) allocated to the property, and any allowable IRC Sec.165 specific built-in loss, and
- f). any other information required by regulation.

This “transfers at death” tax return must be filed with the income tax return for the decedent’s last tax year, the year of death [ IRC Sec. 6075(a) ].

**NOTE:** California estate (death) taxes **expired** for decedents dying after 2004, and no change to this effect has been made by the California Legislature as of 8/15/2010. Estate or death taxes for States other than California is not part of the discussion of this letter. Readers of this letter should consult the appropriate office(s) of the relevant State for information regarding the estate or death taxes of that particular State.

For further discussion, please give us a call at 415-381-0681.

Sincerely,

CHO F CHAN CPA, INC.