nerej CELEBRATING 55 YEARS

New law affects tax basis of inherited property

January 27, 2010 - Front Section

As of January 1st, 2010, the rules regarding the tax basis of inherited property have dramatically changed.

Prior to January 1st, 2010, a beneficiary who inherited an asset of a decedent would receive a tax basis in the inherited asset equal to the fair market value of the asset on the date of the decedent's death. Consequently, if at the time of his death, a decedent owned an asset with a fair market value of $3 million and a basis of $1 million, the beneficiary who inherited the asset would take a $3 million tax basis in the asset; thereby, effectively reducing by $2 million the beneficiary's potential gain on the subsequent sale of that asset.

As of January 1st, 2010, under the new general rule, a beneficiary who inherits an appreciated asset of a decedent will have a basis equal to the decedent's basis in the asset at the time of death. Consequently, using the prior example, the beneficiary would have a $1 million tax basis in the asset, leaving the beneficiary exposed to the $2 million gain.

There are two significant exceptions to this general rule. First, the executor of the decedent's estate may make an election to increase the basis of the appreciated property by as much as $1.3 million plus the amount of the decedent's unused capital loss carryovers, net operating loss carryovers and theft losses. Such increase cannot cause the tax basis to exceed the fair market value of the property. Consequently, using the example and assuming that the decedent did not have any unused capital loss carryovers, net operating loss carryovers or theft losses, the executor could elect to increase the beneficiary's basis in the asset to $2.3 million.

The second significant exception to the general rule applies to property passing to a surviving spouse. Under this exception, the basis of property passing directly to the surviving spouse or as qualifying terminal interest property for the surviving spouse's benefit may be increased by as much as $3 million; provided, that such increase cannot cause the tax basis to exceed the fair market value of the property.

In light of these new basis rules, it is a wise idea to contact your estate planner to determine if any adjustments to your estate plan should be made.

John Varella is an attorney with Lourie & Cutler, Boston, Mass.