

# **Basis and Portability**

**Florida Fellows Institute**

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# What is Basis?

- ◆ Rules have been the same for 100 years.
- ◆ Basis:
  - ◆ Equals what the taxpayer paid for an asset.
  - ◆ Provides way to calculate gain or loss on sale of asset.

# Types of Shrimp



# Types of Basis

- ♦ Cost
- ♦ Adjusted
- ♦ Unadjusted
- ♦ Depreciable
- ♦ Transferred
- ♦ Exchanged
- ♦ Carryover
- ♦ Stepped-up
- ♦ Stepped-down
- ♦ Gain
- ♦ Loss
- ♦ Outside
- ♦ Inside
- ♦ Tax

# Cost Basis

- ◆ **Initial basis = cost basis**
- ◆ **Cost = amount paid for an asset, regardless of its fair market value**
- ◆ **Cost basis is adjusted by adding and subtracting various amounts (e.g., capital improvements)**

# Basis of Gifted Property

- ♦ Appreciated property

- ♦ Donee's basis = donor's basis
- ♦ Donee's basis increased by gift tax paid

- ♦ Example

- ♦ Bob buys 20,000 shares of stock for \$1/share on September 1<sup>st</sup> (purchase price = \$20,000).
- ♦ Bob gifts 20,000 share to Ernie on October 1<sup>st</sup>, when FMV is \$1.50/share (FMV = \$30,000).
- ♦ Bob pays \$2,400 in gift tax.
- ♦ Ernie's basis = \$22,400 (purchase price + gift tax paid).

# Basis of Gifted Property

- ♦ Depreciated property
  - ♦ Rule is different, to prevent TPs from transferring losses from lower bracket TPs to higher bracket TPs.
- ♦ Example #1 – Donee sells depreciated property at a gain
  - ♦ Bob buys of stock for \$100 on September 1<sup>st</sup>.
  - ♦ Bob gifts share to Ernie on October 1<sup>st</sup>, when FMV is \$80.
  - ♦ Ernie sells stock on November 1<sup>st</sup>, for \$125.
  - ♦ Ernie's basis = \$100, and he recognizes \$25 of gain.

# Basis of Gifted Property

- ♦ Depreciated property
  - ♦ Rule is different, to prevent TPs from transferring losses from lower bracket TPs to higher bracket TPs.
- ♦ Example #2 – Donee sells depreciated property at a loss
  - ♦ Bob buys of stock for \$100 on September 1<sup>st</sup>.
  - ♦ Bob gifts share to Ernie on October 1<sup>st</sup>, when FMV is \$80.
  - ♦ Ernie sells stock on November 1<sup>st</sup>, for \$62.
  - ♦ Ernie's basis = \$80, and he recognizes \$18 of loss.

# Basis of Gifted Property

- ♦ Transfers between Spouses
  - ♦ Always treated as gifts, even if consideration is paid.
  - ♦ Donee spouse takes donor spouse's basis in the property, regardless of whether later sale produces gain or loss.
  - ♦ No separate treatment for appreciated and depreciated property.

# **Basis of Property Acquired from Decedent**

- ♦ 1921 to 1976: Basis = date of death value (step up)
- ♦ 1976:
  - ♦ Step up rule repealed, and replaced with carryover basis
  - ♦ Carryover rule
    - ♦ Suspended before it went into effect
    - ♦ Retroactively repealed in 1980
- ♦ 2010:
  - ♦ Transfer taxes repealed
  - ♦ Could elect estate taxes with carryover basis, or no estate taxes and step up

# **Basis of Property Acquired from Decedent**

- ♦ **General Rule – Basis stepped up to DOD value**
- ♦ **If alternate valuation date values are used:**
  - ♦ **Basis = FMV on alternate valuation date.**
  - ♦ **All assets subject to AVD rules – no “pick and choose”.**
  - ♦ **Since AVD values will be lower than DOD values, must compare estate tax and income tax consequences.**

# **Basis of Property Acquired from Decedent**

- ◆ **Property can be acquired from decedent through will, trust, exercise of POA**
- ◆ **Joint property**
- ◆ **QTIP property**
- ◆ **Community property**
- ◆ **Income in respect of decedent**

# Planning with Basis

- ♦ **Compare income tax effects with transfer tax effects.**
- ♦ **Should client gift property to remove it from estate, or retain the property until death instead?**
- ♦ **As exemption amounts rise, basis considerations become more important.**

# September 25, 1981



# August 1, 1981



August 7, 1981

"All the News That's Fit to Print"

# The New York Times

LATE CITY EDITION

VOL. CXXXI No. 4182 NEW YORK, FRIDAY, AUGUST 7, 1981

## IRAN WON'T ALLOW 62 FRENCH CITIZENS TO LEAVE COUNTRY

### BARS THEM FROM PLANES

Misnamed "Irish" Deportees — Tehran Says It Will Let Them Out Next Week

TEHRAN, Aug. 6 — Iran's refusal to permit the departure of 62 French citizens held in Tehran for the past two weeks has been described as a "major step" toward the release of the hostages, Iranian officials said today.

## Sadat Assured Over U.S. Role In the Mideast

### But Reagan Declines to Make Specific Promises

WASHINGTON, Aug. 6 — President Ronald Reagan today assured Egyptian President Anwar el-Sadat that the United States would continue to support his efforts to bring about a settlement of the Arab-Israeli conflict.

## U.S. to Select First Trainees For Controller

### By Robert R. Livingston

WASHINGTON, Aug. 6 — A group of 100 American pilots and ground crew members will be selected to receive training in the operation of the Soviet-made Sukhoi Su-26 fighter plane, the Defense Department announced today.



A member of the command's special operations unit is shown in the background in the foreground, with a tank in the background.

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## Iranian Hostages Released

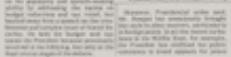
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## Soviet Is Said to Reject U.S. Offer of Afghan Talks

WASHINGTON, Aug. 6 — The United States has rejected a Soviet offer to discuss the withdrawal of Soviet troops from Afghanistan, according to a State Department spokesman today.

## Reagan's Style: Focusing on 'the Big Picture'

WASHINGTON, Aug. 6 — In his first week as president, Ronald Reagan's focus on the "big picture" has been described as a key element of his leadership style, according to a White House spokesman today.



President and Mrs. Reagan today in the White House.

## New Unfettered Marital Deduction Changes Estate and Gift Planning

By ROBERT H. LEBOWITZ

With the tax code rewritten in the wake of the new government tax reform act, estate and gift tax planning has become a more complex task than ever before.

## INSIDE

Ball's Decision to Resign: The 82-year-old former baseball player has announced his resignation from the position of president of the Major League Baseball Players Association.

Spring Changes Detailed: The House of Representatives has passed a bill to change the dates of the spring break for federal government employees.

Problem of Tax Brackets: The new tax law will have a significant impact on the number of taxpayers in each income bracket.

The New Tax Law: The new tax law will have a significant impact on the number of taxpayers in each income bracket.

## U.S. SAYS GOAL NOW IS TO RECONSTRUCT AIR CONTROL FORCE

### LEWIS FEELS SOME 'CHECK'

Traffic Shows Experts Talk as 12,000 of 13,000 Members Remain Off Their Jobs

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# What Is Portability?

- ♦ **Transfer of decedent's unused exemption amount to surviving spouse.**
- ♦ **Eliminates risk that estate tax liability will depend on order of spouses' deaths.**
- ♦ **Available to married decedents dying after 2010.**
- ♦ **Final regulations issued in 2015.**
- ♦ **Does not apply to the GST tax.**

# DSUE Amount

- ♦ “Deceased Spousal Unused Exclusion” amount. (Code section 2010(c)(4))
- ♦ The decedent’s unused exclusion amount in the year of death can be transferred to the surviving spouse.
- ♦ Surviving spouse can only use the DSUE amount of her last deceased spouse.
- ♦ Citizenship:
  - ♦ If decedent spouse ≠ U.S. citizen, can’t elect.
  - ♦ If surviving spouse ≠ U.S. citizen, special rules apply.

# Portability & Basis

- ◆ Traditionally, decedent's unused exemption allocated to credit shelter trust.
  - ◆ Credit shelter trust property doesn't receive step-up in basis on surviving spouse's death.
- ◆ Portability allows all of couple's assets to receive step-up on surviving spouse's death.

# **Alternatives to Credit Shelter Trust**

- ◆ **Property passes outright to surviving spouse**
- ◆ **Property passes to QTIP trust for the benefit of surviving spouse.**
- ◆ **All of the decedent's unused exemption is transferred to surviving spouse.**
- ◆ **On spouse's death, all property transferred to or for the benefit of the spouse receives a step-up in basis.**

# When to Use Portability

- ♦ Small and medium estates
  - ♦ Easy planning
  - ♦ Preserves basis step-up on 2<sup>nd</sup> death
  - ♦ Outright distribution to spouse provides no asset protection
  - ♦ Portability doesn't apply to GST exemption
  - ♦ Need to use QTIP trust to:
    - ♦ Protect assets
    - ♦ Use decedent's GST exemption (reverse QTIP)

# When to Use Portability

- ♦ Large estates
  - ♦ Do the math
  - ♦ Portability may be better than credit shelter trust
  - ♦ But need to consider:
    - ♦ Asset protection
    - ♦ GST planning
  - ♦ Concerns if state death taxes are in play

# **Portability vs. Credit Shelter**

- ♦ **Surviving spouse's life expectancy**
- ♦ **Will surviving spouse remarry?**
- ♦ **Income tax vs. transfer tax consequences**
- ♦ **Anticipated rates of return on assets**
- ♦ **Turn over as part of investment plan**
- ♦ **Consumption by surviving spouse**

# **Portability vs. Credit Shelter**

- ♦ **State estate tax issues**
  - ♦ Does state allow portability?
  - ♦ Does state allow QTIP election?
- ♦ **Asset protection**
  - ♦ Does QTIP provide enough, compared to credit shelter trust?
- ♦ **What changes need to be made to existing plan?**

# Planning Considerations

- ♦ **Consider all facts and circumstances**
- ♦ **Continue traditionally planning, but add flexibility**
- ♦ **Do new planning?**
  - ♦ **Complication and risk**
  - ♦ **Implementation**
  - ♦ **Reliance on surviving spouse to do further planning**

# Electing Portability

- ♦ **Executor makes election on the 706**
  - ♦ **Automatic, unless executor opts out**
  - ♦ **Avoid portability by not filing 706, or by filing late**
- ♦ **Election date relates back to date of death**
- ♦ **If no 706 required:**
  - ♦ **Need to file 706 to elect portability**
  - ♦ **No “short form”**
  - ♦ **Simplified regime for certain assets**

# QTIP Elections

- ♦ **Make QTIP election, even if not necessary to reduce tax to zero, to elect portability.**
- ♦ **IRS will disregard QTIP election if not necessary to reduce tax to zero.**
- ♦ **Rev. Proc. 2016-49: QTIP election on 706 to elect portability is valid.**

# Late Portability Elections

- ♦ **Can't make late election if estate required to file 706**
- ♦ **If no 706 required, can make late election**
- ♦ **Rev. Proc. 2017-34: Provides simplified method for making late portability election**

**THE END**