Treasury Issues Regulations on Basis Reporting Consistency

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Earlier this month, the Treasury Department released proposed and temporary regulations regarding basis consistency reporting with respect to inherited property. The regulations provide guidance with respect to basis reporting requirements and statements that must be furnished to estate beneficiaries and the IRS.

The term "basis" refers to the reference point for measuring gain or loss on the sale or other disposition of property. Typically, the basis of a particular asset is its acquisition cost adjusted for various items such as depreciation and capital improvements. Under section 1014 of the Internal Revenue Code (the "Code"), the basis of certain property inherited from a decedent is "stepped up" to the fair market value of the property at the decedent's date of death. This can be very advantageous to the beneficiary who inherits appreciated property because the basis adjustment to fair market value has the potential to eliminate significant amounts of lurking capital gain.

In July 2015, the President signed HR 3236 into law which added section 1014(f) to the Code. Section 1014(f) requires that the basis of certain inherited property reported when sold by the beneficiary must match the final value reported by the executor for Federal estate tax purposes. In addition to section 1014(f), HR 3236 also created several new reporting and penalty requirements to ensure compliance with the basis consistency obligation of section 1014(f). For example, section 6035 requires that any executor required to file an estate tax return must furnish to the IRS and certain beneficiaries a statement (Form 8971) identifying the value of the inherited property as reported on the estate tax return within thirty (30) days of filing. If a beneficiary reports a different basis with respect to the property than that furnished to the IRS, accuracy related penalties may apply.

Upon initial enactment, sections 1014(f) and 6035 appeared to leave a number of matters unclear. For example, practitioners were unsure whether the Form 8971 reporting requirements would apply to estates that were not subject to estate tax but were required to file an estate tax return for other reasons such as a surviving spouse making portability election to preserve a deceased spouse's applicable exclusion amount.

The proposed regulations set forth some preliminary guidance in resolving these uncertainties. Namely, the basis consistency requirement of section 1014(f) only applies to estates that incur a federal estate tax liability (i.e. taxable estates in excess of $5,450,000 in 2016). In estates where federal estate tax is imposed, the basis consistency requirement does not apply to property passing to a surviving spouse or charity that qualifies for the marital or charitable deduction, respectively, and tangible personal property that does not have a marked artistic or extrinsic value in excess of $3,000. Further, the final value determined for estate tax purposes will serve as the beneficiary's initial basis but the beneficiary is entitled to take account of post-death basis changes.

In addition, the Form 8971 reporting requirements do not apply to returns filed solely for the purposes of electing portability by a surviving spouse or solely for the purpose of making a generation skipping transfer tax election or allocation. There is no Form 8971 reporting requirement for cash (other than for coins or bills with numismatic value), tangible personal property with a value of less than $3,000 or property the estate sells in a taxable transaction and does not distribute to a beneficiary. Added reporting requirements apply if a beneficiary subsequently transfers the inherited property to certain "related transferees" by gift.

Once finalized, the proposed regulations will apply to the estates of decedents filing federal estate tax returns after July 31, 2015. Executors and other fiduciaries should be cognizant of the additional reporting requirements of section 6035, and beneficiaries are well advised to consider the ramifications of the basis consistency requirements of section 1014(f) in taxable estates.

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