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# Agricultural Law Digest

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## Uniform Basis: Who Can Claim Depreciation After Death and How Much?

-by Neil E. Harl\*

Leaving property at death to the surviving spouse for life (a legal life estate or a life estate in trust) with a remainder interest to a child or children has been a fairly common strategy and continues to be used even with the larger applicable exclusion amount<sup>1</sup> and “portability” (which allows the surviving spouse to use the unused applicable exclusion amount at the death of the first spouse to die if the requirements are met).<sup>2</sup> One important issue is how is the income tax basis handled under the “uniform basis” rules? What happens if the holder of the life estate dies first in terms of the effect on income tax basis? And what happens if the holder of the remainder interest dies first? Moreover, what if the estate of the decedent whose death gave rise to the new basis at that individual’s death<sup>3</sup> claims depreciation before the estate passes the property to the life estate holder and the holder of the remainder interest?

### The concept of a “uniform basis”

The regulations have made it clear for a number of years that the income tax basis acquired from a decedent is uniform in the hands of every person having possession or enjoyment of the property involved at any time under the will or trust (or other instrument) or under the laws of descent and distribution.<sup>4</sup> The concept of a “uniform basis” means that the income tax basis is the same (and is uniform) whether the property is possessed and enjoyed by the executor or administrator, an heir (whether the holder of a life estate, remainder or outright ownership), a legatee or devisee or the trustee or beneficiary of a trust created by a will or inter vivos trust.<sup>5</sup>

Factors are provided, based on life expectancies, for use in determining the income tax basis of the life estate interest or term interest as well as the basis for the remainder interest.<sup>6</sup> The income tax basis of the life interest, the remainder interest or the term interest is computed by multiplying the uniform basis by the appropriate factor.

**Example:** Grandfather Jones died leaving 240 acres of farmland to his son for life with a remainder interest to a grandson. The fair market value at death was determined to be \$10,000 per acre or \$2,400,000 for the entire tract. The only depreciable property was tile lines which were ascertained to be valued at \$50,000 as of the date of death which was the amount allocated at death from the new basis at the grandfather’s death.

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If the estate claimed \$2500 in depreciation while the estate was open and before the property passed to the son (for life) and the grandson (remainder interest), the available depreciation after the transfer to the son and grandson would be reduced to \$47,500. The depreciation thereafter could be claimed by the son as holder of the life estate (based on the life expectancy of the holder of the life estate) and ultimately by the grandson (who would be entitled to claim the rest of the depreciation but there would be no new basis at the deaths of either one.<sup>7</sup> Each would be eligible to claim depreciation, first the life tenant and then the holder of the remainder interest. But there would be no new basis at the deaths of either the holder of the life estate or the holder of the remainder interest.

### New basis for the remainder?

If a remainder holder dies before the death of the holder of the life estate, does the remainder holder receive an adjustment in the income tax basis (up to fair market value) of the property in the example? The answer is no, there is no adjustment in the income tax basis at the death of the remainder holder. The uniform basis rules prescribe an allocation of part of the basis determined at the grandfather's death to the remainder holder but deny an adjustment of basis if the remainder holder dies before the holder of the life estate dies.<sup>8</sup> At the death of the life estate holder, the holder of the remainder interest assumes complete ownership and death thereafter produces an adjustment of the basis. But that is not the case if the remainder holder dies before the holder of the life estate dies.

The regulations dealing with the bequest, devise or inheritance of a remainder interest state --

“Where property is transferred for life, with remainder in fee, and the remainderman dies before the life tenant, no adjustment is made to the uniform basis of the property on the death of the remainderman.”<sup>9</sup>

The regulation goes on to state that the successor's basis for the property interest is determined by adding to (or subtracting from) the adjusted uniform basis assigned to the remainder interest the difference between the value of the remainder interest included in the remainderman's estate and the basis of the remainder interest prior to the remainderman's death.<sup>10</sup> An example in the regulations shows how that calculation is handled.<sup>11</sup> Remember, for the distribution of property of decedents, all titles to property acquired by bequest, devise or inheritance, relate back to the death of the decedent, whether the interest is legal, equitable, vested, contingent, general, specific, residual, conditional, executory or otherwise.<sup>12</sup>

Keep in mind that *granted* life estates are not included in the gross estate of the holder of the life estate and, therefore, holders of granted life estates do not receive a new basis at death. By comparison, the holder of a *retained* life estate receives a new income tax basis at death because the property is brought back into the gross estate at death.<sup>13</sup>

### So what happens at the death of the remainder holder after the death of the life tenant?

In a case that arose before the current regulations<sup>14</sup> became final, the taxpayer had acquired an interest from a remainder holder with a life estate held by the grantor's spouse.<sup>15</sup> The question was the taxpayer's basis on sale of the property interest. The court determined that the value related to the fair market value at the death of the decedent-remainder holder from whom the taxpayer had acquired the property interest, not the value when the original testator died.<sup>16</sup> The current regulations, as noted above,<sup>17</sup> reach a much different conclusion. The regulations became final in 1957.<sup>18</sup>

### ENDNOTES

<sup>1</sup> I.R.C. §§ 2010, 2001(b)(2)(B) (inflation adjusted to \$5,340,000 for deaths in 2014).

<sup>2</sup> I.R.C. § 2010(c)(4), (5). See Harl, “Portability – Great Idea But Full of Planning Problems,” 22 *Agric. L. Dig.* 137 (2011).

<sup>3</sup> I.R.C. § 1014.

<sup>4</sup> See I.R.C. § 1014(a); Treas. Reg. § 1.1014-4(a)(1). See also Pierson v. Comm'r, 253 F.2d 928 (3d Cir. 1958; Wilson v. Tomlinson, 61-2 U.S. Tax Cas. (CCH) ¶ 9533 (S.D. Fla. 1961).

<sup>5</sup> Treas. Reg. § 1.1014-4(a)(1).

<sup>6</sup> Treas. Reg. § 1.1014-5(a)(3).

<sup>7</sup> See Treas. Reg. § 1.1014-8(a)(1).

<sup>8</sup> Treas. Reg. § 1.1014-8(a)(1).

<sup>9</sup> Treas. Reg. § 1.1014-8(a)(1).

<sup>10</sup> *Id.*

<sup>11</sup> Treas. Reg. § 1.1014-8(b).

<sup>12</sup> Treas. Reg. § 1.1014-4(b). See Harl, “Income Tax Basis for a Remainder Interest,” 21 *Agric. L. Dig.* 25 (2010).

<sup>13</sup> I.R.C. § 2036.

<sup>14</sup> Treas. Reg. § 1.1014-8(a).

<sup>15</sup> Bauer v. United States, 168 F. Supp. 539 (Cl. Ct. 1958).

<sup>16</sup> *Id.*

<sup>17</sup> See Treas. Reg. § 1.1014-8(a).

<sup>18</sup> T.D. 6265, Nov. 6, 1957.