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The “Safe Harbor” For Those Making The Section 1022 Basis Election For Deaths In 2010

-by Neil E. Harl*

The Internal Revenue Service, on August 7, 2011, issued *Notice 2011-66*¹ and *Revenue Procedure 2011-41*,² both effective August 29, 2011, providing guidance in handling the income tax basis for property owned (and passing from) decedents dying in 2010.³ The executor of the estate can choose (for property acquired from or passing from and owned by the decedent) to – (1) apply the estate tax rate and applicable credit amount for 2011 with a new basis at death (stepped up or down, as the case may be) or (2) elect to apply the rules applicable to deaths in 2010 (no federal estate tax) and use the modified carryover basis rules applicable to deaths in 2010.⁴ With the latter alternative, the procedure is handled substantially as a gift of property is handled inasmuch as both procedures involve application of carryover basis rules.⁵

This article discusses the “safe harbor” for those making the Section 1022 basis election for deaths in 2010.

The “safe harbor” for Section 1022 elections

The *Revenue Procedure*⁶ first cautions that some property is not subject to Section 1022 election treatment. That includes property that constitutes a right to receive income in respect of decedent (such assets did not receive a new basis under pre-2010 law and do not under post-2010 law).⁷ Annuities subject to income tax under I.R.C. § 72 are considered property that has the right to receive an item of income-in-respect of decedent.⁸

Property acquired from the decedent. The guidance then specifies what is meant by “property acquired from the decedent” which is a necessary condition. That includes property acquired from the decedent by bequest, devise or inheritance or by the decedent’s estate from the decedent which includes revocable trusts or trusts with reserved powers, general powers of appointment not created by the decedent, joint tenancy or tenancy by the entirety property and the spouse’s one-half of community property.⁹ That term does not, however, include qualified terminable interest property.¹⁰

Property owned by the decedent. The *Revenue Procedure* then addresses what is meant by “owned by the decedent” which is also a required condition and goes beyond “acquired from the decedent.” That includes property titled in the decedent’s name, co-owned property (whether tenancy in common or joint tenancy or tenancy by the entirety), revocable trust property and community property.¹¹ Property *not* considered owned by the decedent includes – any power of appointment, even a general power; any property transferred to a trust with a retained power to alter, amend or terminate the trust; property transferred to a

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trust with a retained income interest unless the trust property reverts back to the decedent upon death; and any interest in a QTIP (qualified terminable interest property) or similar arrangement funded by a predeceased spouse.¹²

Other property not eligible for basis increase. The *Revenue Procedure* proceeds to identify categories of property which, even though owned by the decedent and acquired from the decedent, is still not eligible for a basis increase.¹³ That includes gifts for less than full consideration within three years of decedent's death (except for property from the decedent's spouse if the property had not been transferred to the spouse during the three-year period in whole or in part by gift or by transfer for less than adequate consideration); foreign personal holding companies; DISCs or former DISCs; foreign investment companies or passive foreign investment companies.

Amount of basis increase. The guidance discusses the amount of the basis increase, which is specified in the statute, and includes –(1) an “aggregate basis increase” of \$1,300,000 plus carryovers/unrealized losses (capital loss carryovers, net operating loss carryovers and losses under I.R.C. § 165; (2) the spousal property basis increase of \$3,000,000 which can be allocated to any or all property owned by and acquired from the decedent that also satisfies the definition of qualified spousal property as well as a testamentary charitable remainder trust if the surviving spouse is the sole non-charitable beneficiary.¹⁴ For non-resident decedents, the amount is \$60,000 and is not increased by any carryovers/unrealized losses.¹⁵

General rules on allocating basis increase. The executor may allocate the available basis adjustment on a property-by-property basis *provided it does not exceed the fair market value of the property as of the date of the decedent's death*,¹⁶ even after the executor has disposed of or distributed the property.¹⁷ The executor cannot allocate any basis increase to increases in value occurring after the decedent's death.¹⁸ The executor can allocate to life estates or remainder interests *except where the property is divided after death into a life estate and remainder*.¹⁹

Determining fair market value. Fair market value is to be determined in the same manner as for federal estate tax purposes.²⁰

Community property. The published guidance makes it clear that the basis increase may be allocated to the surviving spouse's one-half interest in community property, which is in accord with current law generally.²¹

Miscellaneous provisions. The *Revenue Procedure* confirms that, in accordance with property passing by Section 1022 election treated as passing by gift, the holding period for the property includes the time the decedent held the property; the tax character of the property is the same as in the hands of the decedent; and the allowable depreciation deduction for 2010 is computed using the decedent's depreciation method, recovery period and convention applicable to the property with the rules

to be followed in allocating the depreciation allowance between the transferor and transferee.²² For passive loss purposes, taxpayers are to apply I.R.C. § 469(j)(6) (interest of passive activity passing by gift) rather than I.R.C. § 469(g)(2) (disposition by death).

Finally, the guidance lends no support to the rumor that, for deaths in 2010, waiting to sell assets until 2011 or some later year would produce a new basis equal to fair market value.²³

ENDNOTES

¹ 2011-2 C.B. 184.

² 2011-2 C.B. 188.

³ I.R.C. § 1022. See Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, 124 Stat. 3296 (2010). See generally 5 Harl, *Agricultural Law* § 43.01[3][b][iv] (2011); Harl, *Agricultural Law Manual* § 5.04 (2011); 1 Harl, *Farm Income Tax Manual* § 3.20[4][1][F][I][BB] (2011 ed.). See also Harl, “Guidance On Handling Basis Allocation For deaths In 2010,” 22 *Agric. L. Dig.* 121 (2011).

⁴ See I.R.C. § 1022.

⁵ See Rev. Proc. 2011-41, 2011-2 C.B. 188.

⁶ Rev. Proc. 2011-41, 2011-2 C.B. 188.

⁷ I.R.C. § 1022(f).

⁸ Rev. Rul. 2005-30, 2005-1 C.B. 1015.

⁹ Rev. Proc. 2011-41, 2011-2 C.B. 188.

¹⁰ *Id.*

¹¹ *Id.*

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

²² *Id.*

²³ See Harl, “Confusion Over Income Tax Basis for Deaths in 2010,” 21 *Agric. L. Dig.* 81 (2010).