Basis Consistency Rules are Still With Us

Take-Away: Basis consistency regarding assets received from a decedent estate is still required in reporting to the IRS, but some of the more objectionable rules found in the Proposed Regulations have been changed in the Final Regulations.

Background: The basis consistency rules were covered many years ago and apparently were forgotten by many. The rules are back in the news again because the IRS just published its Final Regulations implementing the rules that came into effect back in 2015. The Final Regulations can be found at T.D. 991, published on September 13, 2024, which update the proposed Regulations that were released 8 years ago.

Basis Consistency Rules: The basis consistency rule added IRC 1014(f) to the Tax Code, which provides that a recipient's basis in certain property acquired from a decedent must be *consistent with* the value of the property as finally determined for federal estate tax purposes- not just the value reported on the estate tax return, but any adjustments made to the value after review by the IRS. In addition, under IRC 6035 Personal Representatives and other persons are obligated provide this tax basis information to the IRS and to the property recipients. These basis consistency rules affect the recipients of property acquired from a decedent only if the inclusion of the value of the property in the decedent's gross estate *increases* the federal estate tax liability.

Final Regulations: The Final Regulations will affect Personal Representatives and other persons who are required to file a federal estate tax return based on the value of the decedent's gross estate, and the amount of the decedent's lifetime adjusted taxable gifts, as well as trustees that make in-kind distributions of property initially acquired from a decedent that was subject to the statutory basis-reporting requirements. The Final Regulations go on for several pages, so they will not be summarized here (rest assured, they provide tedious reading!)

Rather, the Final Regulations a couple of important changes (most to the better) from the IRS's earlier Proposed Regulations. These changes, per the IRS, *'substantially reduce the burden on both the IRS and the taxpayers and increase administrability of the proposed rules."* The Final Regulations are effective on September 17, 2024. A few of the important changes in the Final Regulations follow.

Elimination of the Zero Basis Rule: The Proposed Regulations provided that for property discovered after the filing of, or otherwise omitted from, the decedent's federal estate tax return, where that property is not reported before the expiration of the limitation period for assessing the federal estate tax, the final value of the property, and therefore its income tax basis, would be treated as zero [$0.00.] [Proposed Regulation 1.1014-10(c)(3)(i)(B).] This initial interpretation provoked a groundswell of negative comments considering the reality that many recipients of unreported property may not know of, or be involved in, the failure to report the property for estate tax purposes, but who would be punished with a zero-basis assigned to their inherited asset. Apparently, the IRS looked closely at those comments and concluded that it would be best to drop the zero-basis assigned to unreported property. That is good news.

Reporting Requirement: The Proposed Regulations initially imposed *continuing* reporting requirements on recipients who received property from the decedent's estate and who then subsequently transferred the 'inherited' property to third parties. Again, this on-going reporting obligation was challenged by many to be too onerous a burden on the property recipient. In response, the Final Regulations eliminate a reporting requirement for subsequent transfers of property for all beneficiaries, *but not for trustees.*

Exceptions: IRC 1014(f) initially excluded some types of property from the consistent basis rules and the companion reporting requirements under IRC 6035. For example, property that qualifies for the federal estate tax charitable or marital deduction, which does not generally cause an estate tax liability, is therefore excluded from property that is subject to the consistent basis requirement. Or tangible personal property for which an appraisal is not required, is deemed to not generate an estate tax liability, and therefore it too is excluded from the property subject to the consistent basis requirement.

However, the Final Regulations narrow the scope of these exceptions. For example, the tangible personal property exception is limited to only household and personal effects, rather than *any* tangible personal property.

As for property that is partially sheltered from federal estate tax by virtue of the charitable or marital deduction, to the extent that property increases the estate tax liability to the extent that it does not qualify for the deduction, the property will nonetheless be subject to the consistent basis reporting requirement. The Final Regulations note:

"Some examples of property qualifying for only a partial marital or charitable deduction, and therefore, not excepted from the consistent basis requirement, are: (1) a charitable remainder trust, a charitable

lead trust, or a pooled income fund; (2) a trust subject only to a partial QTIP election under section 2056(b)(7); and (3) property divided between the decedent's surviving spouse and a charity if the sum of the deductions for the two interests given to those recipients is less than the value of the property included in the value of the gross estate."

No Estate Tax Return Filed: What if no federal estate tax return is ever filed? To address situations in which no estate tax return is filed, the basis of property acquired or passed from a decedent that is not reported on a federal estate tax return and not otherwise included in the gross estate generally will be determined under IRC 1014(a) without regard to the basis consistency rules of IRC 1014(f). In short, the Final Regulations do not include a specific rule on the income tax basis of *unreported* property.

Conclusion: Many of us have not paid too much attention to federal estate taxes over the past several used due to the extremely large applicable exemption amount each individual can used to shelter their estate from federal estate taxes. With the scheduled *sunset* of the exemption on the horizon, we need to refamiliarize ourselves with the federal estate tax and its companion basis consistency rule. The Final Regulations provide some clarity, but at the end of the day, the basis consistency rules are very complex and impose reporting burdens on the fiduciary administering the decedent's estate.

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