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Gavel to Gavel: 'Basis' step-up at death – free money

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Free money? "Basis" is what you pay for an asset. Sell it at a profit, and get your "basis" back, tax-free, and pay capital gains tax on the profit. Buy for $10, sell for $12, get $10 back tax-free, and pay "capital gains tax" on $2. But if included in your estate when you die, that asset gets a new basis equal to its value at your death (IRC Sec. 1014(a)). If it's worth more when you die than what you paid for it, your estate (or estate beneficiary) will get all $12 free of income or capital gains tax.

Interesting examples. This "new basis" works especially well for assets such as these:

- **Depreciated assets.** Assets can be "depreciated" to get deductions, which offset taxable income. When sold, the owner "recaptures" the deducted amount and pays ordinary income tax (highest federal rate: 37%) on it – instead of (long-term) capital gains tax (highest federal rate: 20%) on those sales proceeds. But included in an estate, the asset gets a new basis to cure this tax headache.
- **Artists and inventors** have "basis" in their art and inventions equal to the cost of materials used to produce them. At death, the artwork and inventions get a date-of-death value basis. So, Michaelangelo sells his David statute and recovers tax-free the cost of marble and chisels. But if David is included in his estate, the estate pays $0 income tax on whatever Christie's sells it for.

A bonus. A new increased ("stepped up") basis at death also avoids the 3.8% "net investment income tax" levied by Obamacare (Sec. 1411 of the Code).

Some of the planner's tools:

- Use grandfather's estate tax exemption by giving him a testamentary "general power of appointment" over an asset (IRC Sec 1041(b)(4)). This will cause the asset to be included in his taxable estate.

- Build a “swap power” into irrevocable trusts (IRC Sec 675(4)) so that grandfather can take low-basis trust property into his hands and give the trust “equivalent value” high-basis property in exchange.
- Have a partnership make an election (IRC Sec. 754) which adjusts the basis of partnership property when a partner dies.
- Calculated use of the estate tax marital deduction when the first spouse dies, and the surviving spouse claims the decedent’s unused estate tax exemption for her own estate (“portability,” Sec. 2010(c)(5)(A). Result: New basis at both deaths.

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