Section 1014, IRC of 1986, as amended

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Problem 1

X died in 2006. Under his will, he bequeathed 100 shares of Acme Stock to his son, S. At the date of X's death, the fair market value of the 100 shares of Acme Stock was $200,000.

What is S's basis in the stock? Sections 1014(a)(1) and 1014(b)(1)

Answer to Problem 1

Basically, §1014(a) provides that the basis of property in the hands of the person acquiring the property from the decedent shall be: 1) the fair market value of the property at the date of the decedent's death <u>or</u> 2) the fair market value at the alternate valuation date (6 months after the decedent's death - §2032) if the alternate valuation date is properly used.

Under §1014(b)(1), property acquired from the decedent includes: "property acquired by bequest, devise, or inheritance…"

S received the stock by bequest. S's basis in the stock is the fair market value at the date of X's death. S's basis is $200,000.

Problem 2

M died in 2006. Under her will she bequeathed 100 shares of Gizmo, Inc. to her daughter, D. At the date of M's death, the fair market value of the 100 shares of Gizmo, Inc. was $400,000. On the estate tax return for M, a proper election was made under section 2032 to value the assets of the estate on the alternate valuation date. On the alternate valuation date, the value of the 100 shares of Gizmo, Inc. was $350,000.

What is D's basis in the stock? Sections 1014(a)(2) and 1014(b)(1).

Answer to Problem 2

Basically, §1014(a) provides that the basis of property in the hands of the person acquiring the property from the decedent shall be: 1) the fair market value of the property at the date of the decedent’s death <u>or</u> 2) the fair market value at the alternate valuation date (6 months after the decedent’s death - §2032) if the alternate valuation date is properly used.

Under §1014(b)(1), property acquired from the decedent includes: “property acquired by bequest, devise, or inheritance…”

Since the alternate valuation date was used for estate tax purposes under §2032, under §1014(a), D’s basis in the stock is $350,000.

Problem 3

F purchased Whiteacre for $100,000. F transferred the ownership of Whiteacre to F and F's son, S, as joint tenants with the right of survivorship. F died. At the date of F's death, the fair market value of Whiteacre was $300,000.

What is S's basis in Whiteacre? Sections 1014(a)(1); 1014(b)(9) and 2040(a). Treasury Regulations § 1.1014-2(b).

Answer to Problem 3

Under §1014(b)(9), property acquired from the decedent includes: property acquired from the decedent by reason of death, by reason of [the] form of the ownership, or by reason of other conditions, if by reason thereof the property is required to be included in determining the decedent's gross estate for federal estate tax purposes.

Since F provided all of the consideration for the jointly held property, under §2040(a), the entire value of Whiteacre ($300,000) is included in F's estate for federal estate tax purposes.

Under §1014(a), S's basis in Whiteacre is $300,000.

Problem 4

H and W are husband and wife. W purchased Blackacre with her own funds. She paid $100,000 for Blackacre. W conveyed Blackacre to H and W as tenants by the entirety. W died. At the date of her death, the fair market value of Blackacre was $400,000.

What is H's basis in Blackacre? Sections 1014(a)(1); 1014(b)(9) and 2040(b). Treasury Regulations § 1.1014-2(b).

Answer to Problem 4

Under §1014(b)(9), property acquired from the decedent includes: property acquired from the decedent by reason of death, by reason of [the] form of the ownership, or by reason of other conditions, if by reason thereof the property is required to be included in determining the decedent's gross estate for federal estate tax purposes.

Under §2040(b), one-half of the value of Blackacre ($200,000) is included in W's estate for federal estate tax purposes.

Under §1014(a), H would receive a basis of $200,000 in the one-half interest included in W's gross estate. H had a basis of $50,000 in the one-half interest that was given to him by W during their lives (§1041).

H's basis in Blackacre is $250,000.

Problem 5

Ms. X created an irrevocable inter vivos trust. The trust provided that A receive the trust income for A's life. Following A's death, the remainder would go to C, or if C had already died, to C's estate. Under the terms of the trust, A had the right to demand all of the trust property during his life.

A died. During his life he never demanded any of the trust property. C survived A and received all of the trust property which consisted of 100 shares of stock of Alpha, Inc. At the date of A's death, the 100 shares of stock of Alpha, Inc. had a fair market value of $300,000.

What is C's basis in the 100 shares of stock of Alpha Inc. Sections 1014(a)(1); 1014(b)(9) and 2041(b). Treasury Regulations § 1.1014-2(b).

Answer to Problem 5

Under §1014(b)(9), property acquired from the decedent includes: property acquired from the decedent by reason of death, by reason of [the] form of the ownership, or by reason of other conditions, if by reason thereof the property is required to be included in determining the decedent's gross estate for federal estate tax purposes.

Under §1014(b)(9), property acquired from the decedent also includes "<u>property acquired through the exercise or non-exercise of a general power of appointment</u>."

Under §2041(a)(2), A died possessed of a general power of appointment over the trust property and this property is included in A's gross estate.

Since C acquired the trust property by the non-exercise of the power of appointment, §1014(b)(9) and §1014(a) provide that C's basis in the shares of stock of Alpha, Inc. is $300,000.

Problem 6

In order for section 1014 to apply, is it necessary for the estate of the decedent to file a federal estate tax return or to pay an estate tax? See Treasury Regulations § 1.1014-2(b)(2).

Answer to Problem 6

Treasury Regulation §1.1014-2(b)(2) provides: “It is not necessary for the application of this paragraph [section 1014] that an estate tax return be required to be filed for the estate of the decedent or that an estate tax be payable.”

Problem 7

X died on January 1, 2002. Under his will, 100 shares of stock of Beta, Inc. was bequeathed to an inter vivos trust that X created before his death. Q was named as the trustee. The trust provided that Y would receive the income from the trust for her life. Following her death, the remainder would go to Z, or if Z had already died, to Z's estate.

At the date of X's death, the 100 shares of stock of Beta, Inc. had a fair market value of $200,000. Y died on January 1, 2007. At the date of Y's death, the 100 shares of stock of Beta, Inc. had a fair market value of $400,000. On August 1, 2007, Q distributed 100 shares of stock of Beta, Inc. to Z. On August 1, 2007, the 100 shares of stock of Beta, Inc. had a fair market value of $450,000.

What is the trust's basis in the 100 shares of stock of Beta, Inc.? Treasury Regulations § 1.1014-4(a).

What is Z's basis in the 100 shares of stock of Beta, Inc.? Treasury Regulations § 1.1014-4(a).

Answer to Problem 7

The trust's basis in the 100 shares of stock of Beta, Inc. is $200,000. Treasury Regulation §1.1014-4(a)(1) provides for the uniform basis rule. "The basis of property acquired from a decedent, as determined under section 1014(a), is uniform in the hands of every person having possession or enjoyment of the property at any time under the will or other instrument or under the laws of descent and distribution. The principle of uniform basis means that the basis of the property…will be the same, or uniform, whether the property is possessed or enjoyed by the executor or administrator, the heir, the legatee or devisee, the trustee or the beneficiary of a trust…"

Treasury Regulation §1.1014-4(a)(2) provides: "[T]here is a common acquisition date for all titles to property acquired from a decedent within the meaning of section 1014, and, for this reason, a common or uniform basis for all such interests…If the bequest is of the residue to trustees in the trust, and the executors do not distribute the residue to such trustees until five years after the death of the decedent, the basis of each piece of property left by the decedent and thus received, in the hands of the trustees, is its fair market value at the time when the decedent dies."

Answer to Problem 7 – Continued for Z

Z's basis in the 100 shares of stock of Beta, Inc. is $200,000.

Treasury Regulation §1.1014-4(a)(2) provides: "If the bequest is to trustees in trust to pay to A during his lifetime the income of the property bequeathed, and after his death to distribute such property to the survivors of a class, and upon A's death the property is distributed to the taxpayer [Z] as the sole survivor, the basis of such property, in the hands of the taxpayer [Z], is its fair market value at the time when the decedent died."

Problem 8

The facts are the same as in <u>Problem 7</u> except that on June 1, 2005, Q, as trustee, sold the 100 shares of stock of Beta, Inc. for $300,000. Q immediately purchased for the trust 200 shares of stock of Alpha, Inc. The purchase price was $300,000.

Y died on January 1, 2007. At the date of Y's death, the 200 shares of stock of Alpha, Inc. had a fair market value of $310,000. On August 1, 2007, Q distributed 200 shares of stock of Alpha, Inc. to Z. On August 1, 2007, the 200 shares of stock of Alpha, Inc. had a fair market value of $280,000.

What is the trust's basis in the 200 shares of stock of Alpha, Inc.? Treasury Regulations § 1.1014-3(c).

What is Z's basis in the 200 shares of stock of Alpha, Inc.? Treasury Regulations § 1.1014-3(c).

Answer to Problem 8

The trust's basis in the 200 shares of stock of Alpha, Inc. is $300,000. Under Treasury Regulation §1.1014-4 (a)(3), when the trustee sold the shares of Beta stock for $300,000, the trust had income or a gain of $100,000. Under Treasury Regulations § 1.1014-3(c), the trust basis in property acquired after the death of the decedent is the cost of the property to the trust, *i.e.* $300,000.

When the 200 shares of stock of Alpha, Inc. is distributed by the trust to Z, Z takes, as his basis, the trust's basis in the stock ($300,000). *See* Treasury Regulations § 1.1014-3(c).

Problem 9

X died on January 1, 2006. Under his will, 100 shares of stock of Beta, Inc. was bequeathed to an inter vivos trust that X created before his death. At the date of X's death, the 100 shares of stock of Beta, Inc. had a fair market value of $90,000.

The inter vivos trust contained a provision that after X's death, B would receive a specific pecuniary bequest from the trust in the amount of $100,000. On December 1, 2006, the trustee distributed to B, in satisfaction of this specific pecuniary bequest, the 100 shares of the stock of Beta, Inc. At the date of the distribution to B, the 100 shares of the stock of Beta, Inc. had a fair market value of $100,000.

What are the tax consequences to the trust? What is B's basis in the 100 shares of the stock of Beta, Inc.? Treasury Regulations § 1.1014-4(a)(3).

Answer to Problem 9

When the trust distributed the 100 shares of stock of Beta, Inc. to discharge its obligation to make a pecuniary bequest of $100,000, the trust had income of $10,000. The trust had a basis in the stock of $90,000. The transaction is the same as if it had sold the stock for its fair market value. The use of the stock was like a sale or exchange.

Treasury Regulation §1.1014-4(a)(3) provides the following example. "[I]f the trustee of a trust created by will transfers to a beneficiary, in satisfaction of a specific bequest of $10,000, securities which had a fair market value of $9,000 of the date of the decedent's death [trust's basis under §1014] and a value of $10,000 on the date of the transfer, the trust realizes taxable gain of $1,000 and the basis of the securities in the hands of the beneficiary would be $10,000."

In Problem 9, B would have a basis in the 100 shares of stock of Beta, Inc. of $100,000.

Problem 10

Mother created a trust during her life. The trust provided that all of the trust income would be paid to daughter, D for D's life. Following D's death, the remainder of the trust would be paid to son, S, or if S had already died, to S's estate. Mother transferred 10,000 shares of stock of Acme, Inc. into the trust. The fair market value of the 10,000 shares of stock of Acme, Inc. at the time they were transferred to the trust was $1,000,000. During her lifetime, Mother reserved the right to revoke the trust.

Mother died and never revoked the trust. At the date of Mother's death, the fair market value of the 10,000 shares of stock of Acme, Inc. was $2,000,000.

What is the trust's basis in the 10,000 shares of stock of Acme, Inc.?

Answer to Problem 10

Under §1014(b)(9), property acquired from the decedent includes: property acquired from the decedent by reason of death, [the] form of the ownership, or other conditions, if by reason thereof the property is required to be included in determining the decedent's gross estate for federal estate tax purposes. Section 2036(a)(2) and section 2038 would include the property in M's gross estate.

Also see **§1014(b)(2). Under §1014(b)(2), property acquired from the decedent includes: property transferred by the decedent during her lifetime in trust to pay the income on the direction of the decedent, with the right reserved to the decedent at all times before her death to revoke the trust. M had the ability during her life to direct the income by revoking the trust and thereby removing D as the income beneficiary. Therefore, section 1014 applies and the trust would have a basis in the 10,000 shares of stock of Acme, Inc. of $2,000,000. This was the fair market value of the stock at the date of M's death.**

Problem 10 – Variation 1

Variation 1: The facts are the same except that prior to the death of Mother, the trustee sold the 10,000 shares of stock of Acme, Inc. for $1,500,000. The trustee immediately reinvested the proceeds from the sale into 12,000 shares of stock of Widget, Inc. At the date of Mother's death, the fair market value of the 12,000 shares of stock of Widget, Inc. was $2, 400,000.

What is the trust's basis in the 12,000 shares of stock of Widget, Inc.? Treasury Regulations § 1.1014-3(d).

Answer to Problem 10 – Variation 1

After M’s death, the trust’s basis in the 12,000 shares of stock of Widget, Inc is $2,400,000.

Treasury Regulations § 1.1014-3(d) provides that the basis to the trustee for any property acquired by the trustee through reinvesting the proceeds of the sale of the original property, shall be the fair market value of such property at the date of the decedent’s death if the property thus acquired is included in the decedent’s gross estate for Federal estate tax purposes. This Regulation provides the following example: Decedent, prior to his death transferred real property into a revocable trust. Prior to the decedent’s death, the trustee sold the real property and invested the proceeds in the stock of Y Company at $50 per share. At the date of decedent’s death, the fair market value of the stock was $75 per share. Since the trust corpus had to be included in the decedent’s gross estate because the decedent reserved the right to revoke the trust, the trust’s basis in the property was $75 per share.

Problem 11

A died. Under his will, 10,000 shares of stock of Beta, Inc. was bequeathed to an inter vivos trust that A created before his death. Z was named as the trustee. The trust provided that B would receive the income from the trust for her life. Following her death, the remainder would go to C, or if C had already died, to C’s estate.

At the date of A’s death, the 10,000 shares of stock of Beta, Inc. had a fair market value of $1,000,000. At the date of A’s death, B is 60 year old. (Assume the section 7520 rate is 6.0%) See Table S Treasury Regulations section 20.2031-7(d).

At the date of A’s death, what is the trust’s basis in the 10,000 shares of stock of Beta, Inc.? At the date of A’s death, what is the value of the uniform basis allocated to B’s life interest? At the date of A’s death, what is the value of the uniform basis allocated to C’s remainder interest? Treasury Regulations § 1.1014-5(a).

Answer to Problem 11 – Basis for Trust

The trust's basis in the 10,000 shares of stock of Beta, Inc. is the fair market value of the stock at the date of A’s death ($1,000,000). Treasury Regulation §1.1014-4(a)(1) provides for the uniform basis rule. “The basis of property acquired from a decedent, as determined under section 1014(a), is uniform in the hands of every person having possession or enjoyment of the property at any time under the will or other instrument or under the laws of descent and distribution. The principle of uniform basis means that the basis of the property…will be the same, or uniform, whether the property is possessed or enjoyed by the executor or administrator, the heir, the legatee or devisee, the trustee or the beneficiary of a trust…”

Answer to Problem 11 – Basis for B and C

Treasury Regulations § 1.1014-5(a) provides that the uniform basis has to be allocated between B and C to determine the basis that B has in her term interest (income for life) and the basis that C has in his remainder interest. Treasury Regulations § 1.1014-5(a)(3) provides that the tables under Treasury Regulations § 20.2031-7 should be used.

Under Table S in Treasury Regulations § 20.2031-7, the valuation factor of a remainder interest after the life interest of a 60 year old at an applicable federal rate of 6% is .33625. Therefore, the valuation factor for the life interest is 1.0 - .33625 = .66375

B's basis in the life income interest is $663,750 ($1,000,000 x .66375).

C's basis in the remainder interest is $336,250 ($1,000,000 x .33625).

Problem 12

The facts are the same as in Problem 11 except that immediately after the death of A, B sold her life interest in the trust to an unrelated person, K, for $663,750.

What are the income tax consequences to B? Section 1001(e); Treasury Regulations § 1.1014-5(b); Treasury Regulations § 1.1001-1(f).

Answer to Problem 12

B has a gain or income of $663,750.

Treasury Regulations § 1.1014-5(b) provides that in determining gain or loss on the sale of a term interest in property, the allocated uniform basis shall be disregarded to the extent and in the manner required by §1001(e) of the Internal Revenue Code.

Section 1001(e)(1) provides that in determining gain or loss from the sale or other disposition of a term interest in property (including an income interest in a trust) the basis determined pursuant to section 1014 shall be disregarded. *See also* Treasury Regulations §1.1001-1(f).

Consequently, for purposes of sale, B's basis is 0.

Problem 12 – Variation 1

Variation 1: The facts are the same as Problem 11 except that 5 years after the death of A, when B is age 65, B sold her life interest in the trust to an unrelated person, K. At the date of the sale, the 10,000 shares of stock of Beta, Inc. had a fair market value of $1,500,000. (Assume the section 7520 rate is 6.0%) See Table S Treasury Regulations section 20.2031-7(d). B sold her life interest for $893,700.

What are the income tax consequences to B? Section 1001(e); Treasury Regulations § 1.1014-5(b); Treasury Regulations § 1.1001-1(f).

Answer to Problem 12 – Variation 1

B has a gain or income of $893,700.

This variation is designed to show that the allocation of the uniform basis changes with the passage of time even though B cannot use her allocated basis to compute gain. The last sentence of Treasury Regulations § 1.1014-5(a)(2) states: "[I]n ascertaining the basis of a life interest, remainder interest, or other interest which has been so transferred, the uniform basis rule contemplates that proper adjustments will be made to reflect the change in relative values of the interests <u>on account of the passage of time</u>."

The original basis in the trust corpus to be allocated to B and C was $1,000,000. When B was age 60 her life interest factor was .66375. At age 65, under Table S, her life interest factor is .59580. Correspondingly, C's remainder factor was originally .33625. With the passage of time (5 years later), C's remainder factor has increased to .40420 (Note .40420 + .59580 = 1.0). *See* Treasury Regulations § 1.1014-5(c), Example 2.

Consequently, B's basis would be $595,800 and C's remainder basis is $404,200. For section 1001(e), B cannot use her basis to compute gain or loss.

Problem 13

The facts are the same as in Problem 11 except that immediately after the death of A, C sold his remainder interest in the trust to an unrelated person, L, for $336,250.

What are the income tax consequences to C? Treasury Regulations § 1.1014-5(a) and (c).

Answer to Problem 13

When C sells his remainder interest for \$336,250, C has no gain.

C's basis in the remainder interest is \$336,250 (\$1,000,000 x .33625) See answer to Problem 11. The rule of section 1001(e) does <u>not</u> apply to a sale of a remainder interest. Treasury Regulations § 1.1014-5(a)(3) provides that C uses his allocated portion of the uniform basis for computing gain or loss.

Gain Realized = Amount Realized (\$336,250) – Adjusted Basis (\$336,250) = 0.

Problem 13 – Variation 1

Variation 1: The facts are the same as Problem 11 except that 5 years after the death of A, when B is age 65, C sold his remainder interest in the trust to an unrelated person, L. At the date of the sale, the 10,000 shares of stock of Beta, Inc. had a fair market value of $1,500,000. (Assume the section 7520 rate is 6.0%) See Table S Treasury Regulations section 20.2031-7(d). C sold his remainder interest for $606,300. What are the income tax consequences to C? Treasury Regulations § 1.1014-5(a) and (c).

Answer to Problem 13 – Variation 1

Five years after A's death, when B is age 65, C's allocated portion of the uniform basis has increased from $336,250 to $404,200. See answer to Problem 12 – Variation 1.

The last sentence of Treasury Regulations § 1.1014-5(a)(2) states: "[I]n ascertaining the basis of a life interest, remainder interest, or other interest which has been so transferred, the uniform basis rule contemplates that proper adjustments will be made to reflect the change in relative values of the interests <u>on account of the passage of time</u>." *See also* Treasury Regulations § 1.1014-5(c), Example 2.

Gain Realized = Amount Realized ($606,300) – Adjusted Basis ($404,200) =
Gain Realized is $202,100

Problem 14

The facts are the same as in Problem 11 except that immediately after the death of A, B sold her life interest in the trust to an unrelated person, K, for $663,750. and C simultaneously sold his remainder interest in the trust to the same unrelated person, K, for $336,250.

What are the income tax consequences to B and C? Treasury Regulations § 1.1001-1(f)(3).

Answer to Problem 14

Section 1001(e)(3) provides that section 1001(e) "shall not apply to a sale or disposition which is a part of a transaction in which the entire interest in the property is transferred to any person or persons." Therefore, when both the term interest (the income interest for life in the trust) and the remainder interest are sold as part of the same transaction, the holder of the term interest gets to use her allocated portion of the uniform basis in computing her gain or loss.

B gets to use her allocated portion of the basis $663,750. See basis calculation to B in answer to Problem 11. Therefore B has no gain.

C has a basis of $336,250 and, therefore, has no gain. See answer to Problem 13.

For an example , see Treasury Regulations § 1.1014-5(c), Example 4.

Problem 14 – Variation 1

Variation 1: The facts are the same as Problem 11 except that 5 years after the death of A, when B is age 65, B sold her life interest in the trust to an unrelated person, K for $893,700. At the same time, C sold his remainder interest in the trust to the same unrelated person, K, for $606,300. At the date of the sale, the 10,000 shares of stock of Beta, Inc. had a fair market value of $1,500,000. (Assume the section 7520 rate is 6.0%) See Table S Treasury Regulations section 20.2031-7(d).

What are the income tax consequences to B and C? Treasury Regulations § 1.1001-1(f)(3); Treasury Regulations § 1.1014-5(a) and (c).

Answer to Problem 14 – Variation 1

Section 1001(e)(3) provides that section 1001(e) "shall not apply to a sale or disposition which is a part of a transaction in which the entire interest in the property is transferred to any person or persons." Therefore, when both the term interest (the income interest for life in the trust) and the remainder interest are sold as part of the same transaction, the holder of the term interest get to use her allocated portion of the uniform basis in computing her gain or loss.

The original basis in the trust corpus to be allocated to B and C was $1,000,000. When B was age 60 her life interest factor was .66375. At age 65, under Table S her life interest factor is .59580. Correspondingly, C remainder factor was originally .33625. With the passage of time (5 years later), C's remainder factor has increased to .40420 (Note .40420 + .59580 = 1.0). *See* Treasury Regulations § 1.1014-5(c), Example 2.

Consequently, B's basis would be $595,800 and C's remainder basis is $404,200. B can use her basis. B's gain is $297,900 ($893,700 - $595,800). C's gain is $202,100 ($606,300 - $404,200). Note: the stock appreciated by $500,000 from $1,000,000 to $1,500,000. The total gain taxed to B and C is $500,000 ($297,900 + $202,100).

Problem 15

A died. Under his will, 10,000 shares of stock of Beta, Inc. was bequeathed to an inter vivos trust that A created before his death. Z was named as the trustee. The trust provided that B would receive the income from the trust for her life. Following her death, the remainder would go to C, or if C had already died, to C's estate.

At the date of A's death, the 10,000 shares of stock of Beta, Inc. had a fair market value of $1,000,000. At the date of A's death, B is 60 years old. (Assume the section 7520 rate is 6.0%) See Table S Treasury Regulations section 20.2031-7(d).

Five years after the death of A, when B is age 65, Z, in his capacity as trustee, sold the 10,000 shares of stock of Beta, Inc. for $1,500,000. Neither B nor C sold their interests in the trust.

What are the income tax consequences to the trust? Treasury Regulations § 1.1014-4(a).

Answer to Problem 15

The trust has income or gain of $500,000. Treasury Regulations §1.1014-4(a)(1) provides for the uniform basis rule. See answer to Problem 7. The trust's basis in the 10,000 share of stock of Beta, Inc. is the fair market value of the stock at the date of A's death, *i.e.*, $1,000,000.

Gain Realized = Amount Realized ($1,500,000) – Adjusted Basis ($1,000,000)
Gain Realized = $500,000.

Problem 15 – Variation 1

Variation 1: The facts are the same except that immediately after the death of A, B sold her life interest in the trust to an unrelated person, K, for $663,750. Five years after the death of A, when B is age 65, Z, in his capacity as trustee, sold the 10,000 shares of stock of Beta, Inc. for $1,500,000.

What are the income tax consequences to B and to the trust? Treasury Regulations § 1.1014-4(a).

Answer to Problem 15 – Variation 1

B has a gain of $663,750. See answer to Problem 12. Treasury Regulations § 1.1014-5(b) provides that in determining gain or loss on the sale of a term interest in property, the allocated uniform basis shall be disregarded to the extent and in the manner required by §1001(e) of the Internal Revenue Code.

The sale by B of the interest in the income interest for life has no effect on the sale by the trustee. Treasury Regulations § 1.1014-4(a)(1) provides: "The sale, exchange, or other disposition by a life tenant or remainderman of his interest in property, will for purposes of this section, have no effect upon the uniform basis of the property in the hands of those who acquired it from the decedent. Thus, gain or loss on sale of trust assets by the trustee will be determined without regard to the prior sale of any interest in the property."

The trustee's basis in the stock is $1,000,000 and the trustee will have a gain of $500,000.

Problem 15 – Variation 2

Variation 2: The facts are the same except that immediately after the death of A, B sold her life interest in the trust to an unrelated person, K, for $663,750. B died five years later. Z, as trustee, distributed the 10,000 shares of stock of Beta, Inc. to the remainderperson, C. At the time of the distribution to C the 10,000 shares of stock of Beta, Inc. had a fair market value of $1,500,000.

What are the income tax consequences to B? What is C's basis in the 10,000 shares of stock of Beta, Inc.? Treasury Regulations § 1.1014-4(a).

Answer to Problem 15 – Variation 2

B has a gain of $663,750. See answer to Problem 15 –Variation 1.

C's basis in the 10,000 shares of stock in Beta, Inc. is $1,000,000.

Treasury Regulations § 1.1014-4(a)(2) provides: "If the bequest is to trustees in trust to pay to A during his lifetime the income of the property bequeathed, and after his death to distribute such property to the survivors of a class, and upon A's death the property is distributed to the taxpayer [C] as the sole survivor, the basis of such property, in the hands of the taxpayer [C], is its fair market value at the time when the decedent died."

PLANNING OPPORTUNITIES WITH SECTION 1014

1. REVERSE GIFTING

Individuals who are below the gift tax exclusion amount may consider making gifts to older generation family members who are also below estate and gift tax exclusion amounts to obtain a step-up in basis on their likely earlier deaths.

The gift transfer must be more than 1year prior to the death of the transferee.Section1014€ provides:

(e) Appreciated property acquired by decedent by gift within 1 year of death

(1) In general - In the case of a decedent dying after December 31, 1981, if—

(A) appreciated property was acquired by the decedent by gift during the 1-year period ending on the date of the decedent's death, and

(B) **such property is acquired from the decedent by (or passes from the decedent to) the donor of such property (or the spouse of such donor), the basis of such property in the hands of such donor (or spouse) shall be the adjusted basis of such property in the hands of the decedent immediately before the death of the decedent.**

(2) Definitions - For purposes of paragraph (1)—

(A) Appreciated property-The term "appreciated property" means any property if the fair market value of such property on the day it was transferred to the decedent by gift exceeds its adjusted basis.

(B) Treatment of certain property sold by estate - In the case of any appreciated property described in subparagraph (A) of paragraph (1) sold by the estate of the decedent or by a trust of which the decedent was the grantor, rules similar to the rules of paragraph (1) shall apply to the extent the donor of such property (or the spouse of such donor) is entitled to the proceeds from such sale.

2. PLACING A GENERAL POWER OFAPPOINTMENT IN AN IRREVOCABLE TRUST

A grantor of a trust can give another person a general power of appointment (lifetime or testamentary) over the trust property. If the holder of the general power of appointment continues to hold the power until death, the property subject to the power is included in that person estate under section 2041(a)(2).

Even if the property passes in the original trust to the named beneficiaries, the property will receive a steeped-up basis under section 1014(b)(9).

See Example 5 in this PowerPoint.