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# IRS Issues Final Regulations on Modified Carryover Basis

TAX  
BY

As the Trump administration begins, the estate planning community is bracing itself for the far-reaching changes to the tax code that our elected leaders have promised. In the meantime, the Internal Revenue Service (the “IRS”) is busy patching holes left over from the last sweeping estate tax overhaul. On January 19, 2017, the IRS issued final regulations regarding the application of the modified carryover basis rules for taxpayers who died in 2010.

Taxpayers and practitioners alike will surely recall the uncertainty surrounding the sunset of the Economic Growth and Tax Relief Reconciliation Act (“EGTRRA”) earlier this decade. EGTRRA facilitated a series of reductions in the top estate tax rates and increases in exemption amounts during the 2000s, followed by a one-year repeal of the estate tax for 2010. The law was scheduled to sunset on January 1, 2011, but last-minute legislation known as the Tax Relief Unemployment Insurance Reauthorization and Job Creation Act of 2010 (“TRUIRJCA”) pushed the date back two years. TRUIRJCA also included provisions that retroactively reinstated the estate tax for 2010.

Executors of decedents who passed away in 2010 were given a choice. Under the first option, executors could elect out of the estate tax regime and instead subject the estate to the modified carryover basis rules under the since-repealed Internal Revenue Code (“the “Code”) Section 1022. The mechanics of Section 1022 were somewhat complex, but as a general rule, recipients of estate property received \$1.3 million in stepped-up basis (an additional \$3 million for surviving spouses). The recipient’s basis in any other assets would be the decedent’s carryover basis. If no election was made, the second option was that the estate tax rules would apply, but the basis of assets in the hands of recipients would be stepped-up to the fair market value of the assets on the date of the decedent’s death.

The final regulations, issued seven years after the fact, amend existing regulations under various sections of the Code to account for the modified carryover basis rules of Section 1022. For example, Treasury Regulation §1.742-1, which governs the basis of a transferee’s interest in a partnership interest, is amended to provide that the basis of a partnership interest acquired from a decedent is determined under Section 1022 if the decedent passed away in 2010 and the decedent’s executor made the Section 1022 election. Provisions affected by the final regulations include qualified rehabilitation expenditures under Section 48, the amortization of goodwill under Section 197, and the rules regarding Section 306 stock.

To clarify, nothing in the final regulations purports to alter or conflict with any

existing laws or published guidance pertaining to Section 1022. The final regulations are seemingly intended to eliminate any ambiguity surrounding the application of Section 1022 in various contexts. In other words, they don't really tell us anything we didn't already know. One former IRS agent suggested that the timing of these final regulations was a bit overdue, likely because the IRS had higher priorities on its plate. We suspect that the IRS will experience no shortage of high priority items in the months to come.

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