



# After IRS Revenue Ruling, Questions and Alternative Strategies for Basis Adjustment

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The Key Wealth Institute is a team of highly experienced professionals from across wealth management, dedicated to delivering commentary and financial advice. From strategies to manage your wealth to the latest political and industry news, the Key Wealth Institute provides proactive insights to help grow your wealth.



The Internal Revenue Service has issued new guidance for establishing the cost basis of assets held in an irrevocable trust at the death of its owner. Essentially, the ruling states that the cost basis for such assets should not be adjusted because they were not acquired or passed from the decedent to the beneficiary under the pertinent provisions of IRC § 1014(a).

However, Revenue Ruling 2023-2 still leaves this question unanswered: Should there be a step-up in basis for assets that are not included in the grantor's gross estate for estate tax purposes but are owned by the grantor for income tax purposes?

## Basis adjustment history

Section 1014(a)(1) of the tax code provides that the basis of property for a person acquiring it is generally its fair market value (FMV) at the date of the owner's death (or on a selected alternate valuation date).

The basis of property is generally stepped up (or down if it has depreciated) to its FMV at the time of death. As a result, heirs will not owe any federal capital gains taxes on any appreciation up to the date of death, which can result in a hefty income tax savings.

Property transferred during the donor's life but still included in the estate would be eligible for a basis step-up because it is part of the donor's gross estate.

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## Assets transferred to an intentionally defective grantor trust

Grantor trusts are often used as an estate planning tool to transfer wealth to future generations. This is a powerful tool when the trust is designed so that it is “intentionally defective,” i.e., not included in the gross estate of the grantor at death for estate tax purposes. Yet, the grantor retains specific powers over the trust so that the grantor is considered the owner for income tax purposes.

For assets transferred to an intentionally defective grantor trust (IDGT) it is unclear whether the property is entitled to a step-up in basis at the grantor’s death. Transfers to an IDGT are usually structured as a “completed gift” at the time of the transfer and the grantor does not hold a beneficial interest in or does not retain certain decision-making provisions that would require the trust asset to be included in the grantor’s gross estate.

IDGTs are grantor trusts for income tax purposes and the grantor is taxed on the income of the trust’s assets. Because the assets of the trust are not included in the grantor’s gross estate for federal estate-tax purposes, the IRS previously concluded that the assets are not entitled to a Section 1014 step-up and the beneficiary carries over the decedent’s basis in the assets. The beneficiary then would be subject to a capital gains tax upon the asset’s appreciation up to the date of death when the asset is sold.

The IRS has not indicated whether a grantor trust’s assets will receive a Section 1014 basis adjustment at the owner of the trust’s death when those assets are not included in the owner’s gross estate. It is unclear why the IRS will not rule on this.

## Revenue ruling 2023-2 implication

Generally, the IRS allows basis adjustment for seven types of property, including property acquired by bequest or through a will or inheritance, but the ruling concludes that none of the property in those categories held in a trust qualifies for the adjustment.

IRS rulings are not binding in federal courts, but most courts generally give deference to them, except for the Federal Tax Court because the rulings can represent the arguments of one of the parties involved in the case.

So, while the ruling supports the IRS position that there is no basis adjustment to assets of the grantor trust upon the death of the grantor, an argument for the opposite conclusion remains.

However, if the taxpayer takes the position that there is basis adjustment and later the IRS wins on its “no basis adjustment” argument, there could be substantial tax and penalties owed. There also could be an understatement penalty for the tax return preparer.

## Strategies to achieving FMV income tax basis

There are other ways to achieve an adjustment to the basis of assets of a grantor trust, including:

### Break out the swap power

The grantor has the ability to swap assets outside of the trust for assets inside the trust of equivalent value. The grantor could swap non-appreciated assets, less-appreciated assets or cash held outside the trust with the trust before death; swapping the low-basis asset held within the trust and moving those low-basis assets outside the trust. Then, upon the death of the grantor, those low-basis assets can receive a new fair market value income tax basis.

### Borrow money and buy low-basis assets from the trust.

The principle behind this strategy is identical to the swap power option — getting low-basis assets out of the grantor’s irrevocable trust and replacing them with high-basis assets. The low-basis asset outside the estate would eventually receive a step-up in basis to FMV at the grantor’s death. In this case, the grantor could borrow money from a banking institution, family member or entity and purchase assets from the trust in exchange for cash. After the grantor’s death, the appreciated asset could be sold and the money borrowed could then be repaid to the lender, with interest.

### Buy the assets inside the trust for a promissory note

The grantor could purchase the assets from the trust in exchange for a promissory note and pay fair market value interest on the note. At the grantor’s death, the assets received in exchange for the note would receive a step-up in income tax basis and could then be transferred back to the trust in satisfaction of the promissory note.



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## Step-up on the death of another person other than the grantor

Someone other than the grantor can have a power of appointment over trust assets. Assets subject to a general power of appointment receive a fair market value income tax basis on the death of the power holder. This may work if the grantor of the trust has a family member or even close friend with a similar or shorter life expectancy than the grantor who may be given a power to appoint assets to creditors of that individual's estate.

## Conclusion

At the death of the grantor, is there a basis adjustment for assets that are not included in the grantor's gross estate for estate tax purposes but are owned by the grantor for income tax purposes?

This is a position that a taxpayer will have to discuss with their tax return preparer and attorney. Opinions differ. There is uncertainty regarding this issue. Proceed with caution. Ultimately, the courts will decide, but we don't know when we will have a definitive answer.

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For more information, [please contact your advisor.](#)



## About the Author

As a Consulting Director for Key Family Wealth's Business Advisory Services unit, Joel T. Redmond is responsible for collaborating with KPBS field and Family Wealth teams to serve the transition advisory needs of private business owners in their pre-transition, mid-transition, and post-transaction phases. He also works closely with the KFW team on serving the wealth advisory needs of UHNW clients nationwide.

Prior to joining Key, Joel served as a financial consultant for Wells Fargo Advisors, where he advised individual and institutional clients on financial planning and investment strategy.

Joel earned a BA in English and General Literature from Binghamton University. He is a Certified Financial Planner® certificant, a Chartered Financial Analyst accredited in business valuation by the AICPA, and an IRS Enrolled Agent. He is a director and past President of the CFA Society of Rochester, a CFP Board Ambassador, an award-winning blogger, and the author of multiple finance publications.



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## About the Author

As the Director, Planning and Advice for Key Private Bank, Tina Myers is responsible for managing the Central Planning Team, as well as overseeing the National Advisory Committee, Monthly National Advisory Call, the Key Wealth Institute, and any financial planning literature developed internally and externally. She works with our Regional Directors of Planning to help facilitate our best thinking and advice delivery to clients.

Tina earned a B.S. in Business Administration from the University of Richmond and an M.Tax from Virginia Commonwealth University. She is a CFP® certificant, CPA/PFS, and is an AEP®. She is Treasurer of the Put-in-Bay Community Swim & Sail Program. Tina received the 2016 Exceptional Service Award from the Cleveland Estate Planning Council and the Circle of Excellence Award by Key Private Bank in 2016 and 2018.



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<sup>1</sup>IRS Revenue Ruling 2023-2, March 29, 2023

<sup>2</sup><https://www.forbes.com/sites/alongassman/2023/04/07/revenue-ruling-2023-2-got-it-wrong-the-casse-for-a-stepped-up-basis-when-the-grantor-dies/?sh=79d884c75d1a>