Inheriting property? Be aware of the basis consistency rules

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If you're in line to inherit property from a parent or other loved one, it's critical to understand the basis consistency rules. Current tax law, passed in 2015, provides that the income tax basis of property received from a deceased person can't exceed the property's fair market value as finally determined for estate tax purposes.

Prior law

Before the 2015 tax law change, estates and their beneficiaries had conflicting incentives when it came to the valuation of a deceased person's property. Executors had an incentive to value property as low as possible to minimize estate taxes, while beneficiaries had an incentive to value property as high as possible to minimize capital gains, if they decided to sell the property.

Current law

The 2015 law requires consistency between a property's basis reflected on an estate tax return and the basis used to calculate gain when it's sold by the person who inherits it. It provides that the basis of property in the hands of a beneficiary may not exceed its value as finally determined for estate tax purposes.

Generally, a property's value is finally determined when:

- Its value is reported on a federal estate tax return and the IRS doesn't challenge it before the limitations period expires;
- The IRS determines its value and the executor doesn't challenge it before the limitations period expires; or
- Its value is determined according to a court order or agreement.

But the basis consistency rule isn't a factor in all situations. The rule doesn't apply to property unless its inclusion in the deceased's estate increased the liability for estate taxes. So, for example, the rule doesn't apply if the value of the deceased's estate is less than his or her unused exemption amount.

Beware of failure-to-file penalties

Current law also requires estates to furnish information about the value of inherited property to the IRS and the person who inherits it. Estates that fail to comply with these reporting requirements are subject to failure-to-file penalties.

An accurate valuation is key

The basis consistency rules can be complex. The bottom line is that if you inherit property from a person whose estate is liable for estate tax, it's important that the property's value be accurately reported on the deceased's estate tax return. Please contact us with any questions.

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