Tax basis planning worth a look if estate taxes aren't a threat

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For many people today, income tax planning offers far greater tax-saving opportunities than gift and estate tax planning. A record-high gift and estate tax exemption — currently $5.49 million ($10.98 million for married couples) — means that fewer people are subject to those taxes.

If gift and estate taxes aren't a concern for your family, it can pay to focus your planning efforts on income taxes — in particular, on basis planning.

Benefits of a "stepped-up" basis

Generally, your basis in an asset is its purchase price, reduced by accumulated depreciation deductions and increased to reflect certain investment costs or capital expenditures. Basis is critical because it's used to calculate the gain or loss when you or a loved one sells an asset.

Under current law, the manner in which you transfer assets to your children or other beneficiaries has a big impact on basis. If you transfer an asset by gift, the recipient takes a "carryover" basis in the asset — that is, he or she inherits *your* basis. If the asset has appreciated in value, a sale by the recipient could trigger significant capital gains taxes.

On the other hand, if you hold an asset for life and leave it to a beneficiary in your will or revocable trust, the recipient will take a "stepped-up" basis equal to the asset's date-of-death fair market value. That means the recipient can turn around and sell the asset tax-free.

Undoing previous gifts

What if you transferred assets to an irrevocable trust years or decades ago — when the exemption was low — to shield future appreciation from estate taxes? If estate taxes are no longer a concern, there may be a way to help your beneficiaries avoid a big capital gains tax hit.

Depending on the structure and language of the trust, you may be able to exchange low-basis trust assets for high-basis assets of equal value, or to purchase low-basis assets from the trust using cash or a promissory note. This allows you to bring highly appreciated assets back into your estate, where they'll enjoy a stepped-up basis when you die. Keep in mind that, for this strategy to work, the trust must be a "grantor trust." Otherwise, transactions between you and the trust are taxable.

Is your basis covered?

Before making any changes to your estate plan, be aware that, if an estate tax repeal is signed into law, it's possible the step-up in basis at death could go away, too. We can keep you apprised of the latest developments and help you determine whether your family would benefit from basis planning.

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