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Income Tax Basis for a Remainder Interest

-by Neil E. Harl

Although less common than a half century ago, it is not at all unusual to see use made of legal life estates and remainders, not to mention life estates and remainders in trust. A major concern is what is the income tax basis for a remainder and what happens if the holder of the life estate predeceases the remainder interest holder? Is the holder of the remainder interest entitled to receive a new income tax basis at death?

The concept of a “uniform basis”

The regulations have made it clear for years that the income tax basis of property acquired from a decedent is uniform in the hands of every person having possession or enjoyment of the property at any time under the will or trust (or other instrument) or under the laws of descent and distribution. That concept, of a “uniform basis,” means that the basis is the same and is uniform whether the property is possessed and enjoyed by the executor or administrator, an heir, a legatee or devisee or the trustee or beneficiary of a trust created by a will or inter vivos trust.

Under the uniform basis rules, the available basis is allocated between and among the property held in a life estate or estates and the remainder interests. Factors are provided, based on life expectancies, for use in determining the income tax basis of the life interest, the remainder interest or the term interest in property on the date the property interest is sold. The income tax basis of the life interest, the remainder interest or the term interest is computed by multiplying the uniform basis (adjusted to the time of sale) by the appropriate factor. For the taxable disposition of a life interest or a remainder interest, the factor used is the appropriate factor appearing in the tables opposite the age (on the date of sale or other disposition) of the person whose death the life interest will terminate.

New basis for remainder?

If a remainder holder dies before the death of the holder of the life interest, does the remainder holder receive an adjustment in income tax basis? As is widely known, granted life estates are not included in the gross estate of the holder of the life estate and holders of such life estates do not receive a new basis at death. As for remainder holders, the regulations dealing with the bequest, devise or inheritance of a remainder interest, state –

“Where property is transferred for life, with remainder in fee, and the remainderman dies before the life tenant, no adjustment is made to the uniform basis of the property on the death of the remainderman.”

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The regulation goes on to state that the successor’s basis for the property interest is determined by adding to (or subtracting from) the adjusted uniform basis assigned to the remainder interest the difference between the value of the remainder interest included in the remainderman’s estate, and the basis of the remainder interest prior to the remainderman’s death.10

An example in the regulations11 shows how that calculation is handled.

Remember, for the distribution of property of decedents, all titles to property acquired by bequest, devise or inheritance relate back to the death of the decedent, even though the interest of the person taking the title was, at the death of the decedent, legal, equitable, vested, contingent, general, specific, residual, conditional, executory or otherwise.12

So what happens at the death of the remainder holder after the death of the life tenant?

In a case that arose before the regulations13 became final, the taxpayer had acquired an interest from a remainder holder with a life estate held by the grantor’s spouse.14 The question was the taxpayer’s basis on sale of the property interest. The court determined that the value related to the fair market value at the death of the decedent-remainder holder from whom the taxpayer had acquired the property interest, not the value when the original testator died.

However, the current regulations, as noted above,15 state that the basis of the remainder holder’s heir, legatee or devisee for the remainder interest is determined by adding (or subtracting from) the part of the adjusted uniform basis assigned to the remainder interest the difference between the value of the remainder interest included in the remainderman’s estate and the basis of the remainder interest immediately prior to the remainderman’s death.16 Those regulations became final in 1957.17

Of course, if the transfer was created by gift, the basis is derived under gift rules in terms of the income tax basis.18

ENDNOTES


2 See I.R.C. § 1014(a).


4 Treas. Reg. § 1.1014-4(a)(1).

5 Treas. Reg. §§ 1.1014-4(a), 1014-5.


7 Id.

8 Treas. Reg. § 1.1014-8(a)(1).

9 Treas. Reg. § 1.1014-8(a)(1).

10 Id.

11 Treas. Reg. § 1.1014-8(b).

12 Treas. Reg. § 1.1014-4(b).


15 See note 9 supra.

16 Treas. Reg. § 1.1014-8(a)(1).

17 T.D. 6265, Nov. 6, 1957.

18 I.R.C. § 1015.