# O'NEIL & STEINER, PLLC
# STEP-UP IN BASIS FOR INHERITED ASSETS

**Step-Up In Basis:**

Typically, when a taxpayer sells stocks, bonds, or real estate they calculate gains or losses by subtracting their cost, referred to as "basis" for tax purposes, from the sales price. If the asset sells for more than their basis, they pay tax on the gain. If the asset sells for less than their basis, they are said to have experienced a loss.

A special adjustment occurs when the owner of an asset passes away and their assets are inherited by their beneficiaries. When inherited assets (stocks, bonds, real estate, etc.) held outside of tax-deferred (401-K, IRAs, etc.) accounts are inherited the beneficiaries are granted a "Step-Up in Basis" for tax purposes. This means the basis of the asset when it was purchased by the decedent is replaced by the fair market value of the asset on the date of death for tax purposes. This adjustment allows the beneficiaries to sell the stock, bond, real estate, or other asset and determine gains or losses by subtracting the fair market value on the date of death (instead of the original purchase price) from the sales price.

For example, let's imagine a single man named Todd purchases 10,000 shares of Ford Motor company stock for $1 per share in 1981 (total investment $10,000). Todd's will leaves his stock to his niece Nikole upon his death. On 11/9/2021 Todd passes away when the stock is valued at $20.12 per share (total value of shares is $100,600). Because the assets receive the "Step-Up in Basis" Nikole is able to sell the stock for $100,600 with no tax liability. Her tax return would show the sale calculation as:

| Sale Proceeds | - | Cost (or other Basis) | = | Gain/Loss |
|---|---|---|---|---|
| $ 100,600 | - | $ 100,600 | = | $ 0 (no gain = no tax) |

This is great news! Let's also consider that if Todd had sold the shares prior to his death and left Nikole the after-tax proceeds his reporting would have been:

| Sale Proceeds | - | Cost (or other Basis) | = | Gain/Loss |
|---|---|---|---|---|
| $ 100,600 | - | $ 10,000 | = | $ 90,600 Gain |

*Assuming a 15% federal + 2.5% state = 17.5% total long-term capital gains taxes, Todd would have to pay $15,855. This would leave Nikole with $15,855 less due to selling the assets rather than letting her inherit them with a Step-Up in Basis.

While this adjustment is called the "Step-Up in Basis" the adjustment could also be a negative one if the asset has declined in value from the time it was purchased. In other words, assets are adjusted to fair market value when inherited whether they have increased or decreased in value.

For example, let's imagine Todd purchased 400 shares of PG&E Corp stock for $25 per share in 1986 (total investment $10,000). On 11/9/2021 Todd passes away when the stock is valued at $12.18 per share (total value of shares is $4,872). Because the assets receive the "Step-Up in Basis" Nikole inherits them at with total basis of $4,872. If she sells for $4,872 is able to sell the stock for $4,872 with no tax liability. Her tax return would show the sale calculation as:

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| Sale Proceeds | - | Cost (or other Basis) | = | Gain/Loss |
|---|---|---|---|---|
| $ 4,872 | - | $ 4,872 | = | $ 0 (no gain = no tax) |

It would have been better for him to sell in this situation. If he sold before he passed his reporting would have been:

| Sale Proceeds | - | Cost (or other Basis) | = | Gain/Loss |
|---|---|---|---|---|
| $ 4,872 | - | $ 10,000 | = | $ 5,128 Loss |

*At least his loss could have helped reduce his taxable income, instead of being lossed altogether.

Since the Step-Up in Basis is required either way it is important to be aware of it for planning and reporting purposes.

It is important to communicate with financial advisors & tax professionals about inherited assets to be sure this Step-Up in Basis is accounted for when reporting to the IRS. We suggest using the following, or similar, language to confirm the assets are adjusted upon death for tax reporting purposes:

*I am contacting you regarding the account of ________________________ who passed away on _____/_____/____.*
*(Name of decedent)*
*(Date of death)*

*After consultation with my CPA, I was urged to contact you to confirm the basis of all assets held in the investment account were adjusted to their fair market value on the date of death, the Step-Up in Basis.*

*Has this adjustment to the basis of assets held as of the date of death already occurred? If not, what do I need to do to be sure this gets taken care of immediately?*