

Part I

Section 671.—Trust Income, Deductions, and Credits Attributable to Grantors and Others as Substantial Owners; § 1014.—Basis of Property Acquired from a Decedent

26 CFR 1.1014-1: Basis of Property Acquired from a Decedent

Rev. Rul. 2023-2

ISSUE

Is there a basis adjustment under § 1014 of the Internal Revenue Code (Code) to the assets of a trust on the death of the individual who is the owner of the trust under chapter 1 of the Code (chapter 1) if the trust assets are not includible in the owner's gross estate pursuant to chapter 11 of the Code (chapter 11)¹?

FACTS

In Year 1, A, an individual, established irrevocable trust, T, and funded T with Asset in a transfer that was a completed gift for gift tax purposes. A retained a power over T that causes A to be treated as the owner of T for income tax purposes under subpart E

¹ Unless otherwise specified, all “section” or “§” references are to sections of the Code or the Income Tax Regulations (26 CFR part 1).

of part I of subchapter J of chapter 1 (subpart E). A did not hold a power over T that would result in the inclusion of T's assets in A's gross estate under the provisions of chapter 11. By the time of A's death in Year 7, the fair market value (FMV) of Asset had appreciated. At A's death, the liabilities of T did not exceed the basis of the assets in T, and neither T nor A held a note on which the other was the obligor.

LAW

Section 671 provides that, where subpart E treats the grantor or another person as the owner of any portion of a trust, the taxable income and credits of the grantor or the other person include those items of income, deductions, and credits against tax of the trust that are attributable to that portion of the trust to the extent that these items would be taken into account under chapter 1 in computing taxable income or credits against the tax of an individual. Any remaining portion of the trust is subject to subparts A through D of part I of subchapter J.

Section 1012(a) provides that the basis of property is its cost, except as otherwise provided in subchapter O of chapter 1 (subchapter O) (relating to gain or loss on disposition of property) and subchapters C (relating to corporate distributions and adjustments), K (relating to partners and partnerships), and P (relating to capital gains and losses) of chapter 1. One of the provisions set forth in subchapter O is § 1014.

Section 1014(a)(1) generally provides that, except as otherwise provided in § 1014 (including § 1014(f) requiring the use of consistent basis), the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent, if not sold, exchanged, or otherwise disposed of before the decedent's death by that person, is the FMV of the property at the date of the

decedent's death.

Section 1014(b) lists the seven types of property that are considered to have been acquired from or to have passed from the decedent for purposes of § 1014(a). The types of property are:²

- Section 1014(b)(1) – Property acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent;
- Section 1014(b)(2) – Property transferred by the decedent during life in trust to pay the income for life to or on the order or direction of the decedent, with the right reserved to the decedent at all times before death to revoke the trust;
- Section 1014(b)(3) – In the case of decedents dying after December 31, 1951, property transferred by the decedent during life in trust to pay the income for life or on the order or direction of the decedent with the right reserved to the decedent at all times before death to make any change in its enjoyment through the exercise of a power to alter, amend, or terminate the trust;
- Section 1014(b)(4) – Property passing without full and adequate consideration under a general power of appointment exercised by the decedent by will;
- Section 1014(b)(6) – Property which represents the surviving spouse's one-half share of community property held by the decedent and the surviving spouse under the community property laws of any State, or United States

² Section 1014(b)(5) applies only to decedents dying before January 1, 2005. Section 1014(b)(7) and (8) were repealed by section 221(a)(74)(B) of the Tax Increase Prevention Act of 2014, Public Law 113-295, 128 Stat. 4010, 4049 (December 19, 2014).

territory or any foreign country, if at least one-half of the whole of the community interest in such property was includible in determining the value of the decedent's gross estate under chapter 11 or § 811 of the Internal Revenue Code of 1939 (1939 Code);

- Section 1014(b)(9) – Property acquired from the decedent by reason of death, form of ownership, or other conditions (including property acquired through the exercise or non-exercise of a power of appointment), if by reason thereof the property must be included in determining the value of the decedent's gross estate under chapter 11 or under the 1939 Code. In this case, if the property is acquired before the death of the decedent, the basis commencing on the death of the decedent is the amount determined under § 1014(a) reduced by the amount allowed to the taxpayer as deductions in computing taxable income under subtitle A of the Code or prior income tax laws for exhaustion, wear and tear, obsolescence, amortization, and depletion on the property before the death of the decedent. However, § 1014(b)(9) does not apply to:

(A) annuities described in § 72;

(B) stock or securities of a foreign corporation that would have been a foreign personal holding company prior to the repeal of § 552 of its next preceding taxable year prior to the decedent's death to which § 1014(b)(5) would apply if the stock or securities had been acquired by bequest; and

(C) property described in any other paragraph of § 1014(b); and

- Section 1014(b)(10) – Property includible in the gross estate of the decedent under § 2044 (relating to certain property for which the marital deduction was previously allowed). In any such case, the basis is determined under § 1014(b)(9) as if such property were described in the first sentence of § 1014(b)(9).

Section 1.1014-1(a) generally provides that the basis of property acquired from a decedent is equal to the value placed upon such property for purposes of chapter 11. Accordingly, generally the basis of property acquired from a decedent is the FMV of such property at the date of the decedent's death, or, if the decedent's executor so elects, at the alternate valuation date prescribed in § 2032. Property acquired from a decedent includes, principally, property acquired by bequest, devise, or inheritance, and, in the case of decedents dying after December 31, 1953, property required to be included in determining the value of the decedent's gross estate under any provision of the Internal Revenue Code of 1954 or the 1939 Code.

Section 1.1014-2(a)(1) provides that property acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, whether the property was acquired under the decedent's will or under the law governing the descent and distribution of the property of decedents, is considered to have been acquired from a decedent and the property's basis is determined under the general rule in § 1.1014-1.

Section 1.1014-2(b)(2) generally provides that property is considered to have been acquired from a decedent to the extent such property is includible in the decedent's gross estate if the decedent died after December 31, 1953.

In Rev. Rul. 84-139, 1984-2 C.B. 168, D, a citizen and resident of foreign country Z,

died owning real property located in Z. B, a United States citizen, inherited the real property in accordance with the laws of Z. At the time of D's death, the property had a basis of \$100x and a FMV of \$1,000x. Because the property was located outside the United States and D was a nonresident alien, the value of the property was not includible in D's gross estate under § 2103 for purposes of chapter 11. B sold the property the following year for \$1050x, claiming a basis of \$1,000x and gain of \$50x. The ruling concludes that, because B inherited the property from D, and the property is within the definition of property acquired from a decedent under § 1014(b)(1), it received a basis adjustment to FMV at D's death and B had correctly calculated B's basis and gain. In Rev. Rul. 84-139, which did not involve a grantor trust, the property at issue was acquired by a bequest.

ANALYSIS

For property to receive a basis adjustment under § 1014(a), the property must be acquired or passed from a decedent. For property to be acquired or passed from a decedent for purposes of § 1014(a), it must fall within one of the seven types of property listed in § 1014(b). Asset does not fall within any of the seven types of property listed in § 1014(b).

First, upon A's death, Asset was not "bequeathed," "devised," or "inherited" within the meaning of § 1014(b)(1). A "bequest" is the act of giving property (usually personal property or money) by will. Black's Law Dictionary (11th ed. 2019). The Supreme Court defined "bequest" as a "gift of personal property by will" for purposes of the predecessor provision of § 102 that, as today, excluded gifts, bequests, devises, or inheritance from gross income for income tax purposes. United States v. Merriam, 263 U.S. 179, 184

(1923).

A “devise” is the act of giving property, especially real property, by will. Black’s Law Dictionary (11th ed. 2019). Volume 97 of the *Corpus Juris Secundum* notes that although “bequest” and “bequeath” strictly refer to a gift by will of personal property, the words may be given a broader meaning to include real property which, under the narrower definition, would be a devise. See 97 C.J.S. Wills § 1861 (2022).

An “inheritance” is property received from an ancestor under the laws of intestacy or property that a person receives by bequest or devise. Black’s Law Dictionary (11th ed. 2019).

In Bacciocco v. United States, 286 F.2d 551, 554-55 (6th Cir. 1961), the court found that property transferred in trust prior to the decedent’s death is not bequeathed or inherited because it did not pass either by will or intestacy. The court stated, “[w]e construe those terms [bequest and inheritance] according to their usual and normal meaning” and noted that the decedent’s death did not transfer the assets to the trust. Id. at 554-56. This does not imply that property in a trust could never fall within the meaning of § 1014 (such as property included in the decedent’s gross estate or property specifically described by §§ 1014(b)(2), (3), or (4)); however, in the facts outlined above, the trust property does not fall within the meaning of those terms.

The Congressional committee report explaining the basis of property acquired from a decedent for purposes of § 1014(b) (then designated § 113(a)(5) of the 1939 Code) stated that the provision “applies basically to property in the decedent’s probate estate and includible in his gross estate under § 811(a) [the predecessor provision of § 2031(a)]. In addition, it applies to property acquired by certain specifically described

methods of disposition which are treated as though the acquisition was by bequest, devise, or inheritance.” H.R. Rep. No 83-1337 at 4407-08 (March 9, 1954). Citing that report, the court in Collins v. United States, 318 F. Supp. 382, 386 (C.D. Cal. 1970) stated, “[i]t seems clear that property cannot be said to come from a decedent by ‘bequest, devise, or inheritance’ unless it is part of the decedent’s probate estate under the laws of the state of his domicile.”³ The court determined that payments made to a widow by her deceased husband’s employers, under contracts negotiated by her husband, did not pass from the decedent under § 1014 and so would not acquire a basis determined by the contract’s FMV at the decedent’s death but instead were income with respect to a decedent that would not receive a basis adjusted to date of death value.

Second, Asset does not fall within any of the remaining types of property listed in § 1014(b). Asset is not described in §§ 1014(b)(2), (3), or (4) because A did not retain a power to revoke or amend T or hold a power to appoint Asset. Asset also is not described by § 1014(b)(6) because it is not community property. Finally, Asset is not described by §§ 1014(b)(9) or (10) because it is not included in A’s gross estate under the provisions of chapter 11. Because at A’s death Asset does not fall within any of the seven types of property listed in § 1014(b), Asset does not receive a basis adjustment under § 1014(a) at A’s death.

HOLDING

A creates T, an irrevocable trust, retaining a power which causes A to be the owner

³ The court in Collins also determined that the wording of § 1014(b) indicated that the list was exclusive, marking the limits of property acquired from a decedent or passing from a decedent, and that a transfer must therefore be within that list before it could be considered as eligible for a basis adjustment under § 1014(a). Id. at 385-86.

of the entire trust for income tax purposes under chapter 1 but does not cause the trust assets to be included in A's gross estate for purposes of chapter 11. If A funds T with Asset in a transaction that is a completed gift for gift tax purposes, the basis of Asset is not adjusted to its fair market value on the date of A's death under § 1014 because Asset was not acquired or passed from a decedent as defined in § 1014(b).

Accordingly, under this revenue ruling's facts, the basis of Asset immediately after A's death is the same as the basis of Asset immediately prior to A's death.⁴

DRAFTING INFORMATION

The principal authors of this revenue ruling are Cynthia D. Morton and Daniel J. Gespass of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this revenue ruling, please contact Ms. Morton at (202) 317-5279 or Mr. Gespass at (202) 317-6859 (not a toll-free call).

⁴ This revenue ruling does not alter the result in Rev. Rul. 84-139. Property acquired from a non-resident non-citizen decedent that is not included in his or her gross estate may receive a basis adjustment under § 1014 if the property is acquired by bequest, devise, or inheritance within the meaning of § 1014(b)(1) or is otherwise specifically described in § 1014(b).