

**DESCRIPTION OF H.R. 13 AND H.R. 4694**  
**RELATING TO**  
**CARRYOVER BASIS**  
**SCHEDULED FOR A HEARING**  
**BEFORE THE**  
**COMMITTEE ON WAYS AND MEANS**  
**ON NOVEMBER 13, 1979**

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**PREPARED FOR THE USE OF THE**  
**COMMITTEE ON WAYS AND MEANS**  
**BY THE STAFF OF THE**  
**JOINT COMMITTEE ON TAXATION**



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## INTRODUCTION

The issue of carryover basis for property passing or acquired from a decedent has been scheduled for a hearing on November 13, 1979, by the Committee on Ways and Means.

In connection with this hearing, the staff of the Joint Committee on Taxation has prepared a pamphlet which includes a discussion of the background and present law relating to this issue and descriptions of H.R. 13 (Mr. Conable), which would repeal carryover basis, and H.R. 4694 (Mr. Fisher), which would revise the existing provisions. The estimated revenue effects from repeal and possible modifications of carryover basis are also presented.



## I. BACKGROUND AND PRESENT LAW

### *In general*

Under the law prior to the Tax Reform Act of 1976, the basis for determining gain or loss from sales of property acquired from a decedent generally was the value of the property at the date of the decedent's death. This was commonly referred to as a "step-up" in the basis of property at death. Thus, if property owned by a decedent had appreciated after it was acquired by the decedent, that appreciation never was subject to the income tax. On the other hand, if nondepreciable property had declined in value after the decedent acquired it, the decline in value never could be deducted for income tax purposes.

Where property is transferred by an inter vivos gift, the basis in the hands of the donee is generally the same as the donor's basis. Also, where income earned by a decedent was not properly includible in his last income tax return, the recipient is taxed in essentially the same manner as the decedent would have been if he had lived to receive it, i.e., the tax attributes are carried over to the beneficiary. In general, this rule applies to items such as unpaid wages which had been earned by a decedent, accrued interest on Series E savings bonds, joint and survivor annuities, and any unreported gain from installment sales. For these items, the recipient is required to report the income but is allowed a deduction for the Federal estate tax attributable to the income.

### *Tax Reform Act of 1976*

The Tax Reform Act of 1976 provided that the basis of most property acquired from a decedent after December 31, 1976, was no longer generally to be determined by reference to its fair market value on the date of the decedent's death.<sup>1</sup> In general, the basis of such property was to be the same as the decedent's basis immediately before death with certain adjustments (i.e., a "carryover basis").

The 1976 provision was added because Congress believed that prior law resulted in discrimination against those persons who sell their property prior to death as compared with those whose property was not sold until after death. Postponement of a sale until after the owner's death could result in all appreciation occurring before death not being subject to the income tax.<sup>2</sup>

<sup>1</sup> The carryover basis provisions were added to the 1976 Act by the Conference Committee. These provisions had been included in a separate bill dealing with estate and gift taxes which had been reported by the Ways and Means Committee. The House did not act on the separate bill. The Senate Finance Committee has not reported a carryover basis provision and, except for approval of the 1976 Act provisions, the Senate has never adopted such a provision.

<sup>2</sup> Depending upon the availability of deductions and credits, an estate tax may be imposed on the entire value (including any unrealized appreciation) of assets included in a decedent's gross estate. In the case of a sale before death, the income taxes attributable to a gain would reduce the amount of the decedent's taxable estate for estate tax purposes.

Congress also was concerned that prior law resulted in persons postponing sales to avoid tax on the appreciation and that this "lock-in" effect impaired the mobility of capital.

In order to prevent a portion of the appreciation from being taxed by both the estate and income tax, an adjustment was provided to increase the carryover basis by Federal and State death taxes attributable to the net appreciation of property subject to tax. In addition, to exempt smaller estates from administrative burdens arising from carryover basis, a \$60,000 minimum basis adjustment was provided. Also, in order to prevent a retroactive effect from the adoption of carryover basis, a "fresh-start" adjustment was provided. Under that adjustment, the basis of an asset acquired from a decedent was to be stepped-up to its value on December 31, 1976, for purposes of determining gain if the asset had been held by the decedent on that date.

### ***Revenue Act of 1978***

The carryover basis provisions were criticized as being extremely complex and administratively unworkable. Administrators of estates testified that compliance with the provisions caused a significant increase in the time required to administer an estate and resulted in raising the cost of administration. In response to the problems raised, the Revenue Act of 1978 postponed for three years the carryover basis provisions, making the provisions applicable only to property of decedents dying after 1979.

### ***Senate Finance Committee Action***

H.R. 3919, the Crude Oil Windfall Profit Tax act of 1979, as reported by the Senate Finance Committee, contains an amendment which would repeal the carryover basis provisions. Under the amendment, the basis of property passing or acquired from a decedent (within the meaning of Code sec. 1014(b)), will be its fair market value at the date of the decedent's death or at the applicable valuation date if the alternate valuation provision is elected for estate tax purposes.

With respect to property passing or acquired from decedents dying after 1976 and before November 7, 1978 (the date after the date of enactment of the Revenue Act of 1978), the carryover basis provisions may be elected by the executor of an estate. This election is provided under the Senate amendment to cover situations where executors and beneficiaries have made sales, bequest funding, and asset retention decisions in reliance upon the carryover basis provisions. If elected, the basis of all carryover basis property considered to pass from the decedent, including jointly owned property passing by survivorship, would be determined under these provisions. The election is to be irrevocably made no later than 120 days after the date of enactment of the bill and in such manner as prescribed by the Secretary of the Treasury.



## II. DESCRIPTION OF H.R. 13 AND H.R. 4694

### A. H.R. 13—Mr. Conable

The bill would repeal the carryover basis provisions. The repeal would be retroactively effective as of the date of enactment of the Tax Reform Act of 1976 (October 4, 1976).

The bill would also repeal the provision of the 1976 Act which limited the basis adjustment for gift taxes imposed on property acquired by gift to the gift tax attributable to the appreciation of the property. Thus, under the bill and as under prior law, the basis adjustment would be for the full amount of gift taxes imposed with respect to the property (including the gift tax attributable to the portion of the value attributable to the donor's adjusted basis).

The bill, as under the provisions of the 1976 Act which were postponed, would also provide that State death taxes are to be allowed as a deduction to recipients who are taxed on items of income in respect of a decedent. The amount deductible for death taxes attributable to items of income in respect of a decedent will be a portion of the death taxes based on the relationship of the net value of the income item to the value of the gross estate.

In addition, the bill would provide that the basis of real property in the hands of the decedent's heir or beneficiary is the value used for estate tax purposes under the special valuation rules for farms and closely held businesses if that valuation provision is elected with respect to the real property. If a recapture of the estate tax savings results from an early disposition or cessation of use of the real property by a qualified heir, the basis of the property would be increased to the value which would have been used for estate tax purposes if special valuation had not been elected. However, if the recapture event occurs during the recapture phaseout period (between 10 years and 15 years after the decedent's death), the increase in basis would be made in accordance with the phaseout percentages determined for recapture purposes.

Under the bill, conforming changes are also made to the basis rules for generation-skipping transfers.

## B. H.R. 4694—Mr. Fisher

The bill would retain the carryover basis provisions scheduled to go into effect on January 1, 1980, but would make significant revisions to them. The principal changes that would be made by the bill are described below.

### *Estate exemption*

Property included in a decedent's estate would not be subject to the carryover basis rules if the fair market value of carryover basis property included in the gross estate is \$175,000 or less. The amount of this exemption would be the same amount proposed by the bill for the minimum basis adjustment applicable to all other estates.

### *Minimum basis*

The \$60,000 minimum basis adjustment under the existing provision would be increased to \$175,000. This increased amount is approximately equal to the exemption equivalent of the unified credit against estate and gift taxes (based on the lowest rates and after it is fully phased in by 1981). Under the bill, the minimum basis adjustment may be allocated at the executor's discretion to any asset included in the gross estate. This adjustment is to be made after the fresh start basis adjustment but before the death tax basis adjustment (rather than after all other adjustments as under the existing provision).

### *Death tax basis adjustment*

Under the existing provision, three separate basis adjustments may be made for death taxes attributable to appreciation, i.e., the Federal estate tax, State death taxes paid by the executor, and State death taxes paid by the beneficiaries. Under the bill, a single adjustment to basis would be made for death taxes attributable to appreciation. In general, the adjustment would be made in reference to the highest marginal tax rate applicable to the decedent's estate. No separate adjustment would be made for State death taxes but the Federal marginal rate used would be without reduction for such State taxes creditable against the Federal estate tax.

In making this adjustment, an overall amount available to be apportioned among assets would be initially computed. That amount would be equal to the highest marginal tax rate applicable to the estate multiplied by the aggregate appreciation of all appreciated carryover basis properties, subject to the limitation that the amount of appreciation so determined cannot exceed the greater of \$175,000 or, in general, the taxable estate. If less than \$50,000 of the estate is taxable at the highest rate, the next lower rate would apply, but the rate would never be less than 30 percent. The aggregate amount could be apportioned by the executor in his discretion among the estate's carryover basis properties, subject to the general limitation that the adjustment for any particular property could not exceed the marginal rate multiplied by the appreciation in that property.

Where an estate qualifies for estate tax deferral on account of closely held business interests, the executor would be permitted to allocate the death tax adjustment to any asset without regard to the general limitation of the marginal tax rate times appreciation. Thus, the executor could allocate the death tax adjustment to property sold to pay the estate tax without incurring any income tax liability. The fair market value of properties eligible for this election would be limited to the sum of the death taxes and funeral and administration expenses. There would be no requirement that the specific proceeds from the sale of the assets benefiting from the special basis allocation be used to pay death taxes or administration expenses.

### ***Exclusion for tangible personal property and treatment of residences***

The personal and household effects exclusion would be increased from \$10,000 to \$25,000, and property eligible for this exclusion would be expanded to include any tangible personal property that was a capital asset in the hands of the decedent.

The bill would also provide an annual \$250 addition to the basis of a personal residence to account for improvements unless a larger amount could be substantiated in any one year.

### ***Fresh start basis adjustment***

Under the existing provision, the adjusted basis of property that the decedent was treated as holding on December 31, 1976, was increased, for purposes of determining gain (but not loss), by the amount by which the fair market value of property on December 31, 1976, exceeded its adjusted basis on that date. In essence, this modification continued prior law with respect to appreciation in property accruing before January 1, 1977, and provides everyone with a "fresh start."

For marketable securities the fresh start adjustment reflects the fair market value established by market quotations on December 31, 1976. In order to avoid the necessity of obtaining an appraisal of other property held on December 31, 1976, the existing provision contains a rule requiring all property, other than securities for which market quotations are readily available, to be valued under a special valuation method. In general, the special rule determined the adjustment by assuming that any appreciation occurring between the acquisition of the property and the date of the decedent's death occurred at the same rate over the entire time that the decedent was treated as holding the property. To avoid proof of basis problems for tangible personal property, the fresh start basis may be determined by discounting the value of the property at an 8-percent rate for the holding period after 1976 and until the date of the decedent's death.

The bill would revise the fresh start rules in several ways. First, the fresh start adjustment would be available for purposes of determining both gain and loss. Also, for property the value of which is not readily determinable on December 31, 1976, without regard to appraisal, the fresh start value would be determined by discounting the estate tax value back to December 31, 1976, utilizing a 6-percent interest rate and subject to a minimum floor of 25 percent of estate tax value. Property, the value of which was readily determinable on December 31, 1976, without regard to appraisals would be given a fresh

start basis equal to the value determined by reference to the appropriate valuation method. Also, the fresh start adjustment could not increase the basis of property above its estate tax value.

***Final determination of basis***

The bill would create a procedure whereby executors may request the Internal Revenue Service to audit the bases of carryover basis assets. It would permit executors to utilize the administrative procedures of the Internal Revenue Service to resolve basis disputes and would create declaratory judgment jurisdiction in the Tax Court to deal with those problems which cannot be settled administratively. Basis determinations which are agreed upon by the Service and the taxpayer or adjudicated would become binding on both the Service and the recipient of the property. If the Service fails to audit a return where the executor has requested a basis audit, the amount shown on the return would be binding unless an heir is able to prove a different basis at the time of a later sale or other disposition of the property.

### III. REVENUE EFFECTS <sup>1</sup> OF H.R. 13 AND H.R. 4694

(Millions of dollars)

Bill	Fiscal years					Long run <sup>2</sup> at 1979 wealth level
	1980	1981	1982	1983	1984	
H.R. 13.....	( <sup>3</sup> )	( <sup>3</sup> )	-36	-95	-163	-833
H.R. 4694.....	( <sup>3</sup> )	( <sup>3</sup> )	-16	-42	-72	-367

<sup>1</sup> Versus present law without postponement.

<sup>2</sup> 20 years, when there is no effect from "fresh start."

<sup>3</sup> Revenue loss of less than \$5 million.

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