

KNOW WHAT TAX BASIS YOU'RE IN

- Accounting meaning of “basis” for GAAP, is generally, cost. The same is true in taxation (*IRC Sec. 1012*). Exception for individual statements of Net Worth, where often a fair market value amount is shown. Generally, this is not allowed for GAAP reporting (but see new “fair value reporting” for derivatives and other certain property), but sometimes... for tax. See below.
- Often an error-prone area in taxation and, gain or loss reporting. This is due to taxpayer and sometimes practitioner, lack of knowledge, or mistakes of fact. Can be a significant error if not correctly reported.
- Examples of Tax Basis Differentiation:
 - o Adjusted basis (*IRC Sec. 1011*): increased for additions to basis; decreased for reductions to basis; decreased for depreciation “allowable or allowed” (discuss impact), and other factors (*see IRC Sec. 1016*)
 - o Tax basis is used for:
 - Determining gain or loss on sale or other disposition of property
 - Setting depreciable basis of property on which annual depreciation and/or amortization deductions will be based
 - For calculation of “substituted” or “carryover” bases for property received in a tax-deferred exchange”
 - IRC Section 1031: tax-deferred exchanges; DISCUSS vehicles used in a trade or business
 - Gifts received (*IRC Sec. 1015*); will be lesser of donor’s cost basis, or fair market value of gift at the time of gifting
 - Tax-deferred contributions to capital of closely-held corporations, partnerships, LLC’s, tenancies in common, trusts where no gain or loss is recognized as a result of the securities or value of new interest to be received in exchange for the property transferred
 - Tax-deferred distributions to a shareholder, partner etc. of an entity where a partial liquidation occurs
 - Bifurcated basis: where total cost is allocated to depreciable and non-depreciable portions (think: real property land and buildings); also can be where a portion of an asset is abandoned and written off due to an event (think a building which caught fire; the land, however, remains, upon which a new building is built)

- Stepped-up basis (*IRC Sec. 1014(b)(6) in general*): property received from a decedent; also, importantly in community property states: where a married decedent, both spouses receive full bases step-ups at date of death of first to die spouse. Second to die spouse's property will then also receive another basis step-up to his/her heirs.
- Partially substituted or carryover basis (think when a Sec. 1031 exchange results in some recognition portion such as when there is cash paid in addition to exchange proceeds use in the acquisition of the replacement property. Both should be distinguished on a return.
- Inside basis/Outside basis: where a partnership or LLC interest is sold to a new owner, they are allowed to have "specially allocated depreciation" for the basis increase to the entity property if so elected by the partnership and reported to the new partner/member
- Property received by a resident alien from the estate of an alien and then sold: foreign assets held by a resident alien will receive the US equivalent of a typical Sec. 1014(a) basis step-up to the fair market value as of the date of decedent's death, or alternate valuation if so elected, thus reducing their gain on resale of such property, or increasing their loss
- Discharge of indebtedness (*IRC Sec. 1017*): a discharge of indebtedness is often not recognized as income for tax purposes, but, it will then generally reduce the basis of any asset which the debt was secured by

- How to prove Tax Basis:
 - Original cost records
 - Improvements/additions records: invoices and proof of payment
 - Keep property basis records from date of acquisition to date of sale, plus four years after date of file of tax return which shows disposition of the asset
 - Photographs and/or drawings
 - Building permits filed and obtained
 - Note: no basis increase is allowed for "bartered" basis improvements received

- Current importance of Filing US Form 706: Estate Tax Return – specifically to document and evidence stepped up basis even when not required or over the estate exemption amount:
 - Provides a third-party document to substantiate basis for the heirs, and a complete detailed listing of all property transferred by the estate
 - Starts and conclude the statute of limitations for the Form 706, and basis amounts for tax purposes of the heirs

- Questions and answers.