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BEARING360 WEALTH

Planning Corner

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This quarter's *Planning Corner* explores The Tax Benefit Hiding in Your Estate Plan: how tax basis and the step-up at death can reduce your heirs' taxes, and the strategies we consider.

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The Tax Benefit Hiding in Your Estate Plan

How thoughtful step-up-in-basis planning can preserve more after-tax wealth for the next generation

The Central Idea

For affluent families, tax basis is more than an accounting number. It can materially influence how much wealth heirs ultimately keep.

Why Tax Basis Matters

Effective wealth transfer requires looking beyond estate tax. Tax basis can materially affect the wealth retained by heirs, especially when a family owns highly appreciated securities, real estate, closely held businesses, or investment portfolios accumulated over decades.

Traditional estate planning often focuses on reducing estate-tax exposure. Yet the income-tax benefits available at death can be just as important and are sometimes overlooked or poorly coordinated with the broader plan. Thoughtful basis planning may reduce embedded capital gain, improve beneficiaries' flexibility, and increase the after-tax value of the family's assets.

Under Internal Revenue Code §1014, qualifying property acquired from a decedent generally receives a new income-tax basis equal to fair market value at death. This adjustment, commonly called a "step-up in basis," can eliminate substantial appreciation that accrued during the decedent's lifetime. For high-net-worth families, coordinating ownership, gifting, trust planning, and estate inclusion can therefore be an important part of preserving family wealth.

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What is a Step-Up in Basis?

Tax basis is the tax system's measure of an owner's investment in an asset. Suppose an investor purchased stock for $500,000 and it is now worth $3 million. A lifetime sale would generally expose $2.5 million of appreciation to capital-gain tax. If the investor instead owns the stock at death and the property qualifies for §1014 treatment, the basis would generally reset to $3 million. A later sale at $3.1 million would generally produce only about $100,000 of post-death gain.

Important Distinction

"Step-up" is convenient shorthand. Technically, §1014 provides a basis adjustment. Appreciated property may step up, while depreciated property may step down to its applicable date-of-death value.

Assets That May Receive a Basis Adjustment

Taxable investment portfolios. Stocks, bonds, ETFs, mutual funds, and similar investments held outside retirement accounts are classic candidates.

Real estate. Primary residences, vacation homes, rental property, farmland, and commercial real estate may qualify, especially when original basis is low.

Closely held businesses. Privately held stock, partnership interests, and LLC interests may qualify, although entity structure and inside-versus-outside basis issues require additional analysis.

Personal property. Artwork, collectibles, and other valuable personal property may fall within the basis-at-death framework.

Trust-owned assets. Trust ownership alone neither guarantees nor prevents a basis adjustment. Trust terms, powers, ownership, and estate-inclusion rules all matter.

Assets That Require Different Treatment

Traditional IRAs, 401(k)s, nonqualified annuities, and other income-in-respect-of-a-decedent assets generally do not receive the traditional §1014 adjustment available to appreciated capital assets. A $5 million taxable portfolio and a $5 million traditional IRA can therefore have very different after-tax economics for heirs.

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Estate Tax & Basis are Different Questions

A family does not need to owe federal estate tax for qualifying property to receive a basis adjustment. This creates an important planning tension: estate-tax planning may favor moving appreciating assets outside the estate, while income-tax planning may favor positioning selected low-basis assets for a basis adjustment at death.

A Better Planning Question
Instead of asking only, “How do we reduce estate tax?” ask, “Which assets belong inside the estate, which belong outside it, and what produces the best total after-tax result?”

Lifetime Gifts vs. Inherited Assets

Lifetime gifts generally carry the donor’s existing basis. Qualifying inherited property generally receives a basis tied to value at death. The difference can materially affect which assets are best suited for lifetime gifting.

Illustration	Lifetime Gift	Inheritance
Current value	$5,000,000	$5,000,000
Owner’s basis	$500,000	$500,000
Recipient basis (simplified)	$500,000	$5,000,000
Embedded gain (simplified)	$4,500,000	$0

This does not mean appreciated assets should never be gifted. It means every gifting strategy should weigh both transfer-tax savings and the income-tax basis transferred to the next generation.

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Married Couples: Ownership Can Change the Result

At the first spouse's death, the form of ownership can materially affect the basis adjustment. In a simplified common-law property example, only the decedent's ownership interest is adjusted. Qualifying community property may receive more favorable treatment under IRC §1014(b)(6), potentially adjusting both spouses' halves when the statutory requirements are met.

$4 Million Portfolio	Common-Law Illustration	Qualifying Community Property
Original combined basis	$1,000,000	$1,000,000
Value at first death	$4,000,000	$4,000,000
Potential post-death basis	$2,500,000	$4,000,000
Remaining embedded gain	$1,500,000	$0

Why it Matters

An additional $1.5 million of basis can give the surviving spouse substantially more flexibility to diversify, rebalance, or raise cash without carrying the same pre-death embedded gain.

Community Property Planning for Non-Community Property Residents

Some jurisdictions offer elective community-property trust frameworks, but this is not simply a tax election. Property characterization can affect ownership rights, management, divorce, creditor exposure, and disposition at death. Families considering these strategies should coordinate qualified estate counsel and tax advisors, particularly when multiple states are involved.

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The One-Year Rule

IRC §1014(e) limits certain short-term transfers designed to create a basis adjustment. In simplified terms, appreciated property transferred to a person who dies within one year may lose the anticipated basis benefit for the original donor or the donor's spouse if the property returns to either of them. This rule is especially relevant in "upstream" basis-planning strategies.

A High-Net-Worth Family Example

Consider a married couple with a $25 million net worth: an $8 million taxable portfolio with $2 million of basis, $5 million of commercial real estate with $1 million of basis, $4 million of retirement assets, a $3 million residence, and $5 million of other investments and property.

Asset	Value	Illustrative Basis	Embedded Gain
Taxable portfolio	$8.0M	$2.0M	$6.0M
Commercial real estate	$5.0M	$1.0M	$4.0M
Other assets	$12.0M	Varies	Requires review

The family's $25 million net worth tells only part of the story. Under these simplified assumptions, the taxable portfolio and commercial property alone contain approximately $10 million of embedded gain. A comprehensive plan asks not only where the wealth is, but where the tax liability is.

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A Basis-Planning Checklist for Affluent Families

- Inventory major assets and document current fair market value and adjusted basis.
- Quantify unrealized gain for each major asset.
- Review title and ownership: individual, joint, revocable trust, irrevocable trust, or business entity.
- Separate retirement and other IRD assets from ordinary capital assets.
- Revisit prior gifts and determine whether highly appreciated assets remain appropriate lifetime gifts.
- Review older irrevocable trusts for basis-planning opportunities and trade-offs.
- For married couples, evaluate the basis consequences of the applicable marital-property regime.
- Compare retaining appreciated assets with charitable-giving opportunities.
- Preserve appraisals, brokerage statements, estate reporting, and other basis documentation.

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Six Basis-Planning Strategies We Consider

The most effective basis planning is rarely a single transaction. It requires ongoing coordination among investment, tax, and estate-planning decisions as family circumstances, asset values, and tax laws change.

1. Coordinate Asset Ownership Between Spouses

For married couples in common-law property states, ownership of highly appreciated assets can materially affect the basis adjustment available at the first spouse's death. Although no one can predict the order of death, age, health, life expectancy, and the estate plan's terms may support holding a greater share of appreciated assets in the estate of the spouse more likely to die first.

Transfers between spouses generally receive favorable federal gift- and income-tax treatment, which can provide flexibility to reposition assets as circumstances change. Any ownership change should still be coordinated with estate counsel and tax advisors, particularly when trusts, creditor protection, state property law, or dispositive provisions are involved.

2. Plan Carefully Around the One-Year Rule

The anticipated order of death does not always unfold as expected. When a spouse's health declines, repositioning appreciated assets may be worth evaluating, but IRC §1014(e) must be addressed.

If appreciated property is transferred to a person who dies within one year and the property then passes back to the original donor or the donor's spouse, the anticipated basis increase may be limited. In appropriate circumstances, estate counsel may evaluate whether a properly structured trust for multiple beneficiaries can meet the family's objectives without returning the property directly to the donor or donor's spouse.

This is a highly technical area. Trust terms, beneficiaries, powers, estate inclusion, and ultimate disposition must all be evaluated before implementation.

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3. Give Investment Real Estate Special Consideration

Investment real estate can present one of the most compelling basis-planning opportunities. Long-held property may contain substantial appreciation and may also have a very low adjusted basis after years of depreciation deductions.

When qualifying real estate receives a basis adjustment at death, the heir's basis generally becomes the property's applicable fair market value rather than the decedent's old adjusted basis. For income-producing property, heirs may also begin a new depreciation schedule using the portion of the new basis properly allocated to depreciable improvements. This may allow heirs to sell near the date-of-death value with limited post-death gain or retain the property and potentially benefit from new depreciation deductions.

For owners who want to leave direct property management, a properly structured §1031 exchange into a Delaware Statutory Trust, or DST, may offer a more passive real estate investment while continuing tax deferral. If retained until death and otherwise qualifying, the DST interest may also be eligible for a basis adjustment. DSTs involve investment, liquidity, financing, sponsor, and tax risks and require careful review.

4. Compare State Estate Tax with the Basis Benefit

In states with a separate estate tax, minimizing estate tax should not automatically be the sole objective. In some cases, the income-tax benefit of retaining a highly appreciated asset until death may exceed the additional state estate tax created by including that asset in the estate.

The analysis should compare the marginal estate-tax cost of inclusion with the potential income-tax benefit from eliminating embedded gain, reducing future depreciation-recapture exposure, and creating additional depreciable basis for heirs. The outcome depends on adjusted basis, depreciation history, fair market value, applicable federal and state tax rates, and the family's intended use of the asset.

For Minnesota families, this comparison can be especially important because Minnesota's estate-tax exemption is substantially lower than the federal exemption. The objective is not to minimize one tax in isolation, but to achieve the strongest overall after-tax result.

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5. Revisit Irrevocable Trusts That May No Longer Produce the Best Result

Many irrevocable trusts were created when exemptions, asset values, family circumstances, or tax laws were very different. A trust that once delivered a meaningful estate-tax benefit may now hold highly appreciated assets outside the grantor's gross estate, potentially preventing a basis adjustment at the grantor's death.

Trust ownership alone does not determine basis treatment. The analysis depends on trust terms, retained powers, estate inclusion, applicable state law, and IRC §1014. When an older trust no longer produces the family's best overall result, legal counsel may evaluate distributions, modification, decanting, exercise of existing powers, or termination.

We work proactively with clients' legal and tax advisors to identify older structures that may warrant review so estate-tax and income-tax planning remain coordinated.

6. Use Asset Location Intentionally

Retirement accounts, nonqualified annuities, and other income-in-respect-of-a-decedent assets generally do not receive the same basis adjustment available to qualifying appreciated capital assets. By contrast, stocks and other growth-oriented investments held in taxable accounts may benefit from preferential long-term capital-gain and qualified-dividend rates during life, while also potentially receiving a basis adjustment if retained until death.

This does not mean equities should always be held in taxable accounts or excluded from retirement accounts. Asset location should reflect expected return, tax efficiency, withdrawal needs, required distributions, charitable goals, estate objectives, and the investment role of each account. The goal is to place assets where they can produce the strongest overall after-tax result during the client's lifetime and for the next generation.

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The Takeaway

Basis planning is not a one-time estate-planning exercise. It is an ongoing process of coordinating investments, ownership, trusts, gifting, and taxes as circumstances change.

Questions to Bring to Your Advisory Team

- Which assets on our balance sheet carry the largest embedded gains?
- Are low-basis assets positioned to receive a basis adjustment without creating an unacceptable estate-tax cost?
- Do our trusts still produce the intended tax result under current law and current asset values?
- Would a charitable strategy, ownership change, or real-estate restructuring improve the family's total after-tax outcome?
- Do we have the records and valuations our heirs will need to substantiate basis?

Selected Authorities

- Internal Revenue Code §1014 - Basis of Property Acquired from a Decedent
- IRC §1014(b)(6) - Community Property
- IRC §1014(e) - Appreciated Property Acquired by Decedent by Gift Within One Year of Death
- IRC §1015 - Basis of Property Acquired by Gift
- IRC §2032 - Alternate Valuation
- IRS Revenue Ruling 2023-2 - Grantor trust property excluded from the gross estate

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