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TAX AND WEALTH ADVISOR ALERT–UNDERSTANDING THE "STEP-UP IN TAX BASIS": A SUMMARY OF IRC SECTION 1014 AND DOUBLE STEPPED-UP BASIS FOR MARITAL PROPERTY IN WISCONSIN

When a loved one passes away, the emotional toll can be overwhelming, and dealing with the complexities of tax implications may not be a priority. However, understanding the concept of "step-up in tax basis" can significantly impact the tax burden on inherited assets. In this blog post, we'll explore the basics of the step-up in tax basis, focusing on IRC Section 1014, and how Wisconsin's marital property laws can provide a double stepped-up basis for inherited assets.

What is a "Step-Up in Tax Basis"?

Under normal circumstances, when you sell an asset that has appreciated in value since you acquired it, you are subject to capital gains tax on the difference between the purchase price (cost basis) and the selling price. However, when an individual passes away and bequeaths assets to their heirs, these assets receive a "step-up in tax basis." This step-up means that the tax basis of the inherited assets is adjusted to their fair market value on the date of the decedent's death. As a result, any unrealized capital gains up to that point are effectively wiped out, reducing or eliminating the capital gains tax burden for the heirs.

IRC Section 1014: Understanding the Legal Basis for Step-Up

The Internal Revenue Code provides the legal framework for the step-up in tax basis. Specifically, IRC Section 1014 outlines the rules governing the determination of the basis of property acquired from a decedent. According to this section, the basis of inherited property is generally its fair market value at the date of the decedent's death. There are certain exceptions and adjustments depending on the nature of the asset and the circumstances of the transfer, but the general principle remains the same: assets inherited after someone's passing receive a new, stepped-up tax basis.

It is important to note that certain types of assets such as 401(k)s, annuities, or IRAs do not

receive the step-up in basis as these assets contain what is known as “Income in Respect of Decedent.” These assets are subject to income tax when inherited by the heirs.

Double Stepped-Up Basis for Marital Property in Wisconsin

Wisconsin is one of the nine states in the United States that follows a community property system. Under this system, certain assets acquired during a marriage are considered marital property, jointly owned by both spouses. When one spouse dies and leaves their share of the marital property to the surviving spouse, the tax basis of the deceased spouse’s share is stepped-up to its fair market value on the date of their death, as per IRC Section 1014.

Now, here’s where Wisconsin’s marital property law provides an added benefit. When the surviving spouse inherits the deceased spouse’s share of the marital property, the tax basis receives another step-up to its fair market value on the date of the surviving spouse’s death. This is known as a “double stepped-up basis.”

The double stepped-up basis can be highly advantageous for the surviving spouse and their heirs. It allows the appreciation of a certain asset owned during the marriage to be shielded from capital gains taxes entirely if the asset is later sold by the surviving spouse’s heirs. This significant tax benefit can help preserve more of the family’s wealth and provide more financial flexibility for future generations.

Conclusion

The step-up in tax basis is a critical concept to understand when dealing with inherited assets. Under IRC Section 1014, inherited assets generally receive a new tax basis equal to their fair market value on the date of the decedent’s death, eliminating or reducing the capital gains tax burden. In Wisconsin, the marital property laws add an extra layer of advantage by providing a double stepped-up basis for assets acquired during a marriage. This double step-up can have a substantial positive impact on the overall tax liability for the surviving spouse and their heirs, offering a valuable tool for preserving family wealth and passing it on to future generations.