



THE IRS PUTS ITS STAKE IN THE GROUND WITH RESPECT TO STEP UP IN BASIS ON GRANTOR TRUSTS NOT INCLUDED IN TAXABLE ESTATE

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With IRS Revenue Ruling 2023-2, the IRS is attempting to eliminate a position trumpeted by certain estate and gift tax practitioners and commenters since 2002.

In 2002, certain practitioners and commenters began to argue that a trust which is excluded from a decedent's taxable estate still received a step up in basis for capital gains tax purposes if the trust was a "grantor" trust for income tax purposes at the time of the grantor's death. The result would be that the appreciated assets in the trust would have their cost basis stepped up to the fair market value as of the date of death while still not being subject to estate tax. If assets were sold the day after the date of death, assets could pass both income tax and estate tax free to the trust beneficiaries. The position was supported by Private Letter Ruling 201245006. However, Private Letter Rulings cannot be relied on by anyone other than the taxpayer who submitted the request.

In Revenue Ruling 2022-3 released in March of 2022, the IRS indicated it would not issue further rulings or determination letters on the subject. And now a year later, the IRS has taken a clear position in new Revenue Ruling 2023-2. This new Revenue Ruling states the IRS position that assets owned in a grantor trust that is excluded from the grantor's taxable estate do not fall within the meaning of property received by "bequest, devise or inheritance" or "by the decedent's estate" in section 1014 of the Internal Revenue Code and are therefore not entitled to an adjusted tax basis.

A Revenue Ruling is binding on the IRS and can be relied upon by a taxpayer but Revenue Rulings are not binding on the Tax Court or any other Courts as they are simply a statement of the IRS position.

The practical effect of the Revenue Ruling is that Executors and Trustees who wish to report a step up in basis for assets in a grantor trust not otherwise included in the grantor's taxable estate must disclose that they are taking a position contrary to substantial authority which may increase the penalties available to the IRS. It also means that a taxpayer would have to challenge the Revenue Ruling in a courtroom as opposed to dealing with the issue on audit or directly with the IRS.

If you have any questions, please contact your Cummings & Lockwood LLC Private Clients Attorney.