Understanding the “step-up in basis” when inheriting assets

If you inherit assets after a loved one passes away, they often arrive with a valuable — but frequently misunderstood — tax benefit called the step-up in basis. Below is an overview of how the rule works and what planning might need to be done.

What “basis” means

First, let’s look at a couple definitions. *Basis* is generally what the owner paid for an asset, adjusted for improvements, depreciation, return of capital, etc. *Capital gain (or loss)* equals the sale price minus the basis.

At death, many capital assets (stocks, real estate, business interests, collectibles, crypto, etc.) are *stepped up (or down)* to their fair market value (FMV) as of the date of death (or, if elected by the executor, the “alternate valuation date” six months later). The heir’s new basis is that FMV, erasing the tax on any unrealized gain or loss that accumulated during the deceased person’s life.

For example, your father bought ABC stock many years ago for $50,000. At his death, it’s worth $220,000. Your inherited basis is $220,000. If you sell immediately for $220,000, there’s no capital gains tax. Hold it and sell later for $260,000 and you’ll only recognize the $40,000 gain since the date of death.

Some assets don’t receive a stepped-up basis. For example, 401(k)s and IRAs are excluded.

Actions for heirs and future estates

There are some steps that heirs and individuals planning their estates can take.

After a death, heirs should:

- Document the FMV of assets on the date of death. You can use brokerage statements, appraisals, Zillow printouts, cryptocurrency exchange screenshots, etc.
- Retitle assets into your name or trust as soon as possible to avoid administrative issues.
- Keep meticulous records. You may sell years later, or the IRS may question you.

Asset owners planning ahead should:

- Inventory low-basis assets you plan to hold and include in your estate.
- Harvest losses strategically to offset gains you can't eliminate through a step-up.
- Coordinate gifting and lifetime transfers. Remember that gifts use a carry-over basis. This means if you are given a gift (rather than an inheritance), your basis is generally the same as the donor's was when the gift was made.

Good records and proactive planning

These are the basic rules. Other rules and limits may apply. For example, in some cases, a deceased person's executor may be able to make an alternate valuation election. And gifts made just before a person dies (sometimes called "death bed gifts") may be included in the gross estate for tax purposes.

Reach out to us for tax assistance when estate planning or after receiving an inheritance. We'll help you chart the most tax-efficient path forward.