Tax Expert Jim Ciocia Explains The Rules Of "Stepped-Up Basis"

Tax season is now upon us and Jim Ciocia of Gilman Ciocia, a leading provider of federal, state and local tax planning and preparation services explains below the very important tax rule of "stepped-up basis," an IRS provision which provides an incentive for taxpayers to retain appreciated property until death and sell depreciated property while they are alive.

Jim Ciocia

When we sell an asset, such as a stock or a home, we are required to report the sale on our tax return and pay tax on the difference between the sale price and the original cost of the asset. This cost is referred to as the "basis" and is the original cost plus improvements. For example, if we purchased 100 shares of XYZ Company at $60 per share for a total cost of $6,000 and we sold XYZ Company when it was $100 per share or total sale price of $10,000, we are required to pay tax on the $4,000 profit from the sale.

However, we often own assets that we did not buy, which were either given to us or which we inherited. There are rules to determine the basis for this circumstance. When we receive a gift, we also get the basis from the donor. So if we are given the 100 Shares of XYZ Company from someone who paid $60 per share, then our basis is the same $6,000. Even though when it was given to us, the 100 shares XYZ was selling for $100 per share. Our gain is the same as it would be if the donor had sold the shares.

When we inherit an asset, we have a cost basis of the fair market value at the date of death. So if someone bought XYZ for $60 per share and when they died, XYZ was selling for $100 per share, then our cost basis is $10,000. This is much better.

Let's look at the following scenario of the basis for our home, which is the cost at the date of purchase plus all of the improvements. Mr. and Mrs. Smith purchased a home in 1985 for $100,000 and over the years, they put in $50,000 in improvements. Their cost basis is $150,000. If this home is a principal residence, taxpayers are allowed to exclude the gain on $250,000 for a single taxpayer and $500,000 for a married couple. Mr. and Mrs. Smith sell the house in 2007 for $1,000,000. Their gain is $1,000,000 minus $150,000 minus $500,000 or **$350,000**.

What happens if one of them dies before they sell the home? Assume for a second that Mr. Smith passed away in 2005 when the home had a value of $800,000. Mrs. Smith's basis is one-half the original cost plus improvements or $75,000 plus half the value at the date of Mr. Smith's death or $400,000 which totals $475,000. If she sells in 2007 for $1,000,000, her gain is $1,000,000 minus $475,000 minus exclusion of $250,000 or **$275,000**.

This rule is important to consider, as it means that when assets are sold, there will be less taxable gain.

About Gilman + Ciocia, Inc.

Gilman Ciocia is a leading provider of federal, state and local tax preparation services to individuals in Florida, New York, New Jersey, Connecticut, and Pennsylvania. Founded in 1982, Gilman Ciocia caters to middle and upper income taxpayers who face an increasingly complicated tax code and must choose from a growing array of investment options. Gilman Ciocia is a member of the National Association of Tax Professionals and is recognized among the Top 40 accounting firms nationwide in 2006 by *Accounting Today* Magazine. Visit www.gilcio.com or call **1.800.TAX.TEAM** for more information.

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