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THE TAX REFORM ACT OF 1976, SECTION 1023:
TAX REFORM GONE AWRY?

INTRODUCTION

On October 4, 1976, the 94th Congress enacted the Tax Reform Act of 1976.1 The Act was designed both to simplify the tax laws and to make them more equitable.2 Some of the most significant reforms were made in the estate and gift tax provisions of the Internal Revenue Code.3 The reforms in this area were designed to effect a substantial diminution in the tax burden imposed upon small and medium-sized estates without causing a loss of revenue to the Treasury.4

An integral component of the reforms in the estate and gift tax provisions is the revision of the basis treatment accorded property acquired from a decedent.5 Prior to the Tax Reform Act of 1976, the Internal Revenue Code provided that property acquired from a decedent received a basis equal to the property's fair market value on the date of the decedent's death.6 This

5. Id. at H10,227. Basis is a fundamental tax concept. As provided in I.R.C. § 1001, it is the value from which gain or loss is determined upon the sale of property. General basis rules are provided in I.R.C. §§ 1011 to 1019. I.R.C. § 1012 provides that the basis of property shall be the cost of such property, except as otherwise provided in the Code. Although the provision for determining the basis of property acquired from a decedent is codified in the income tax section of the Code, I.R.C. § 1014, it is utilized extensively in estate planning and therefore is often referred to as an estate tax provision. See Abbin, Daskal & Carlson, supra note 3, at 742. But see H.R. Rep. No. 1380, 94th Cong., 2d Sess. 177-80, reprinted in [1976] U.S. CODE CONG. & AD. NEWS 3356, 3431-35 (supplemental views of Hon. O. Burleson, J. Waggoner, Jr., J. Pickle, J. Martin and W. Ketchum with respect to the carryover basis provision).

Except as otherwise provided in this section, the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent shall, if not sold, exchanged, or otherwise disposed of before the decedent's death by such person, be the fair market value of the property at the date of the decedent's death, or, in the case of an election under either section 2032 . . . its value at the applicable valuation date prescribed by those sections.

Id. § 1014(a).

The fair market value of property was deemed to be the value at which the property was appraised for the purpose of determining the federal estate tax. Treas.
Tax Reform

was referred to as a “stepped-up” basis and was regarded as a very significant estate planning device because it conferred tax benefits not only upon the decedent but also upon the recipient of the decedent’s property. The appreciation in the value of a decedent’s property occurring between the decedent’s acquisition of such property and the date of death was never realized and, consequently, permanently escaped federal income taxation.

The recipient of the decedent’s property was taxed, upon a subsequent sale or exchange of such property, only on the appreciation occurring after the decedent’s death. Thus, the “stepped-up” basis provision provided a means of tax avoidance for people in high income brackets.

In an effort to eliminate the inequities inherent in this provision, Congress enacted section 1023 of the Tax Reform Act of 1976, revising the basis treatment accorded property acquired from a decedent. Section 1023 provides that certain types of property acquired from a decedent after


8. “It is fundamental that all economic gain is not taxable income and that it is the realization of income that is the taxable event.” Williamson v. United States, 292 F.2d 524, 530 (Ct. Cl. 1961). See also I.R.C. §§ 61, 1001; Treas. Reg. § 1.61-1(a) (1954). Realization of income results from dispositions of property that are of such a nature that they warrant the taxation of gain received from such dispositions. S. SURREY, W. WARREN, P. MCDANIEL & H. AULT, 1 FEDERAL INCOME TAXATION 818 (1972). “[A]s a basic policy decision, gifts and testamentary dispositions do not, generally speaking, constitute dispositions producing a realization of income under the present statutory structure.” Id. Therefore, neither the decedent personally, nor the decedent’s estate, is taxed on the appreciated value of the decedent’s property when such property is transferred to the decedent’s beneficiary.

In light of the concept of realization of income, the “stepped-up” basis provision enabled a decedent to transfer property at death with the assurance that the appreciation in value that had occurred while the property was in the hands of the decedent would never be realized. See Abbin, Daskal & Carlson, supra note 3, at 742; Heckerling, supra note 6, at 247; Stansbury & Blazek, Revamped basis rules have far-reaching implications, 46 J. TAX. 14, 14 (1977) [hereinafter cited as Stansbury & Blazek]. See generally Slawson, Taxing as Ordinary Income the Appreciation of Publicly Held Stock, 76 YALE L.J. 623, 626 (1967).


The “stepped-up” basis provision had been criticized as a tax avoidance device in the hands of the wealthy, because they could more readily afford to retain property until death and thereby reap the benefits of a step-up in basis. A Senate Budget Committee study indicated that the failure to tax the appreciated value of property at death cost the Treasury between $6 billion and $7 billion a year; and that forty-two percent of this benefit went to taxpayers in the $50,000 income bracket or higher. Andrews, Tax Reform Act to Make Dec. 31 Landmark Date, N.Y. Times, Dec. 29, 1976, at 37, col. 1.

December 31, 1976 will have the same basis as such property had in the hands of the decedent. This treatment is referred to as "carryover" basis, a concept previously utilized in reference to property acquired by inter vivos gift. As a result of this change, the unrealized appreciation inherent in a decedent's property will no longer permanently escape federal income taxation to the extent possible under the "stepped-up" basis provision.

This Comment will review the historical development of the basis treatments accorded property acquired from a decedent and property acquired by inter vivos gift, as well as the criticisms leveled at the "stepped-up" basis provision. It will then explain the change in the basis treatment accorded property acquired from a decedent implemented by the Tax Reform Act of 1976, and discuss the relative merits of selecting the "carryover" basis contained in section 1023 as the means to effectuate reform of the "stepped-up" basis provision.

**HISTORICAL BACKGROUND**

Comparisons are often made between the basis treatment accorded property acquired from a decedent and the basis treatment accorded property acquired by inter vivos gift. These comparisons are made because both types of acquisitions involve the gratuitous transfer of property. Prior to 1921, there were no provisions in the federal tax law for determining the basis of property in the hands of a recipient who had acquired such property either by inter vivos gift or from a decedent. In the absence of statutory

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12. Tax Reform Act of 1976, Pub. L. No. 94-455, §1023(a)(1), 90 Stat. 1520 (amending I.R.C. §1014 (1954)). This basis is subject to various adjustments as further provided by §1023(a)(1), (c)-(e), & (h). For a further discussion of the basis provision and the various adjustments, see notes 57 to 92 and accompanying text infra.

13. I.R.C. §1015, the operative basis provision for property acquired by inter vivos gift, provides that in most cases the donor's adjusted basis in property is "carried over" to the donee of such property. For a discussion of the "carryover" basis provision as applied to inter vivos gifts, see notes 14 & 30 infra.

14. With the various adjustments permissible under §1023, some appreciation in the value of property acquired from a decedent will continue to escape taxation. For a discussion of this aspect of §1023, see notes 71 to 86 and accompanying text infra.

The "carryover" basis provision, as applied to property acquired by inter vivos gift, prevents permanent escape from taxation of unrealized appreciation inherent in property acquired from the donor by according the donee of such property the donor's adjusted basis in the property. Tax on this appreciated value is deferred until sale or exchange of the property by the donee, at which time the gain realized from the difference between the donor's adjusted basis in the property and such property's fair market value at the time of sale, is subject to income taxation. See Castruccio, Becoming More Inevitable? Death and Taxes . . . and Taxes, 17 U.C.L.A. L. Rev. 459, 460 (1970) [hereinafter cited as Castruccio]. See also Stansbury & Blazeck, supra note 8, at 14.


16. E.g., Castruccio, supra note 14, at 460; Heckerling, supra note 6, at 247-52, 259-60; Stansbury & Blazeck, supra note 8, at 14, 16.

17. See Heckerling, supra note 6, at 249.

TAX REFORM guidelines, it was the practice of the Bureau of Internal Revenue to fix the basis of such property in the hands of its recipient at the fair market value of the property on the date of transfer.\textsuperscript{19} The result of this practice was to provide the recipient with a "stepped-up" basis.\textsuperscript{20} In 1918, the Treasury issued a regulation establishing the basis of property acquired from a decedent or by \textit{inter vivos} gift.\textsuperscript{21} In reference to the former, the regulation provided that "[t]he appraised value at the time of death of a testator is the basis for determining gain or profit upon sale subsequent to death."\textsuperscript{22} In reference to the basis of property acquired by \textit{inter vivos} gift, the regulation provided that "[t]he fair market price or value of stock acquired by gift... is the basis for computing gain derived or loss sustained by the sale thereof."\textsuperscript{23} Basis provisions relating to property acquired from a decedent and property acquired by \textit{inter vivos} gift were first codified in the Revenue Act of 1921.\textsuperscript{24} The Act retained the policy of the Bureau of Internal Revenue, as embodied in the Treasury regulation, of according property acquired from a decedent a "stepped-up" basis. It provided that "[i]n the case of such property, acquired by bequest, devise, or inheritance, the basis shall be the

\textit{the Federal Income Tax, 1913-1948}, 2 \textsc{Nat'L Tax J.} 12, 16 n.12 (1949) [hereinafter cited as Wells]. See Waterbury, \textit{A Case for Realizing Gains at Death in Terms of Family Interests}, 52 \textsc{Minn. L. Rev.} 1, 4 n.21 (1967) [hereinafter cited as Waterbury].

19. \textsc{Taft v. Bowers}, 278 U.S. 470, 471-72 (1929) (argument for petitioner); Castruccio, \textit{supra} note 14, at 460; Wells, \textit{supra} note 18, at 16 n.12. See Heckerling, \textit{supra} note 6, at 251. The reason for according property acquired from a decedent and property acquired by gift a basis equal to its fair market value on the date of transfer apparently derived from the concepts of unrealized and realized appreciation in the value of property. Gifts and testamentary dispositions were not viewed as dispositions that produced a realization of income and therefore, the donor or decedent was not taxed on the appreciated value of the transferred property. Since no tax was imposed upon the transferor for appreciation in value which occurred while the property was in his hands, the policy was to allow the transferee to start anew and not be taxed on any appreciation that had previously occurred while the property was in the hands of the transferor. See generally Waterbury, \textit{supra} note 18, at 4.

20. For a discussion of the term "stepped-up" basis, see note 6 \textit{supra} and note 30 \textit{infra}.


The Revenue Act of 1918, ch. 18, § 202(a), 40 Stat. 1058 (1919), relating to basis treatment, did not specifically refer to property acquired by bequest, devise or descent, but was interpreted by the Treasury in the above regulation to apply to such acquisitions. See Waterbury, \textit{supra} note 18, at 4 n.21.


23. \textit{Id.} para. 41. Although this regulation refers only to stock acquired by gift, Bureau practice prior to 1921 was to accord all property acquired by \textit{inter vivos} gift a basis equal to its fair market value at the time of transfer. See \textsc{Taft v. Bowers}, 278 U.S. 470, 471-72 (1929) (argument for petitioner); Wells, \textit{supra} note 18, at 16 n.12.

fair market price or value of such property at the time of such acquisition.” 25 However, with regard to the basis of property acquired by *inter vivos* gift, the Act deviated from the policy of the Bureau of Internal Revenue by providing that “[i]n the case of such property, acquired by gift after December 31, 1920, the basis shall be the same as that which it would have been in the hands of the donor or the last preceding owner by whom it was not acquired by gift.” 26 As a result of this revision, recipients were accorded a “carryover” basis for property acquired by *inter vivos* gift. 27

Thus, beginning in 1921, property acquired from a decedent and property acquired by *inter vivos* gift were accorded disparate basis treatment, the former receiving a “stepped-up” basis 28 and the latter receiving a “carryover” basis. This disparate basis treatment was continued under all subsequent revisions of the Internal Revenue Code, so that with only minor variations, the Internal Revenue Code of 1954 29 accorded property acquired from a decedent and property acquired by *inter vivos* gift the same basis treatment as first codified in the Revenue Act of 1921. 30

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26. Revenue Act of 1921, ch. 136, § 202(a)(2), 42 Stat. 227 (1921) (current version at I.R.C. § 1015 (1954)), as amended by Tax Reform Act of 1976, Pub. L. No. 94-455, § 1040(c), 90 Stat. 1520. The reason for this change in basis treatment accorded property acquired by *inter vivos* gift was “to prevent avoidance of the capital gains tax through gifts of appreciated property to others in whose hands appreciations prior to the date of the gift were nontaxable.” Wells, supra note 18, at 16. See Farid-Es-Sultaneh v. Commissioner, 160 F.2d 812, 815 (2d Cir. 1947); Heckerling, supra note 6, at 251–52.

27. Waterbury, supra note 18, at 6. See also Farid-Es-Sultaneh v. Commissioner, 160 F.2d 812, 815 (2d Cir. 1947). For a discussion of the term “carryover” basis, see notes 13 & 14 supra.

28. See Stansbury & Blazek, supra note 8, at 14. Although generally referred to as the “stepped-up” basis provision, property acquired from a decedent could also receive a “step-down” in basis if the fair market value of such property on the date of the decedent’s death was less than the decedent’s adjusted basis in the property. However, because of the continual inflation in real property values a “step-down” in basis was a rare occurrence. In instances where property values, real or other, had in fact decreased, the decedent normally would have disposed of the property prior to death and realized a loss on the transaction. See Sutter, supra note 21, at 462. See also H.R. REP. No. 1380, 94th Cong., 2d Sess. 36–46, reprinted in [1976] U.S. CODE CONG. & AD. NEWS 3356, 3390–400.


30. For a discussion of the pertinent provisions of the Revenue Act of 1921, see notes 24 to 26 and accompanying text supra.

The variations in the basis treatment accorded property acquired by *inter vivos* gift and property acquired from a decedent, from the basis treatment provided for in the Revenue Act of 1921, ch. 136, § 202(a)(2)–202(a)(3), 42 Stat. 227 (1921), generally relate to contingencies not contemplated by the Revenue Act of 1921. Property acquired by *inter vivos* gift continued to receive a “carryover” basis equal to the donor’s adjusted basis in such property, I.R.C. § 1015(a). However, pursuant to a
CRITICISM OF THE “STEPPED-UP” BASIS PROVISION

Although the basis treatment accorded property acquired from a decedent and property acquired by *inter vivos* gift remained virtually unchanged for fifty-five years, the “stepped-up” basis treatment accorded property acquired from a decedent was subjected to continual criticism and demands for reform. Critics of the “stepped-up” basis provision contended that the provision had three fundamental flaws.31 First and foremost, the “stepped-up” basis provision contributed to the economic phenomenon known as “lock-in.”32 The term “lock-in” describes the situation in which property owners are motivated by external factors to retain their property.


(1) In general. — If—

(a) the property is acquired by gift on or after the date of the enactment of the Technical Amendments Act of 1958, the basis shall be the basis determined under subsection (a), increased (but not above the fair market value of the property at the time of the gift) by the amount of gift tax paid with respect to such gift.

This section has been amended by the Tax Reform Act of 1976, Pub. L. No. 94–455, § 1040(c), 90 Stat. 1520. Section 1040(c) amends I.R.C. § 1015(d) with the addition of subsection (6). This subsection provides that in the case of any gift made after December 31, 1976, the donor’s basis is to be increased only by that portion of the gift tax which is allocable to the net appreciation in value inherent in the gifted property. See Stansbury & Blazeck, supra note 8, at 16. This change was effected so that the increase to the donor’s basis for the payment of gift taxes would be the same as the increase allowed to the decedent’s basis for the payment of estate and inheritance taxes under the “carryover” basis provision embodied in § 1023. See notes 81 to 82 & 85 to 86 and accompanying text infra. The Code also included a special basis rule for property acquired by *inter vivos* gift when the donor’s basis was greater than the fair market value of the property at the time of transfer. I.R.C. § 1015(a). This section provides that, for purposes of determining loss on a subsequent sale of such property by the donee, the property’s basis shall be its fair market value at the time of transfer, but, for purposes of determining gain the normal “carryover” basis rule applies and the property’s basis is that of the donor. This provision regarding special treatment for losses was first enacted in the Revenue Act of 1934, ch. 227, § 113(a)(2), 48 Stat. 706 (1934). See Heckerling, supra note 6, at 252; Wells, supra note 18, at 22.

Property acquired from a decedent continued to have a “stepped-up” basis in the hands of the recipient. I.R.C. § 1014(a) (1954), as amended by Tax Reform Act of 1976, Pub. L. No. 94–455, §§ 1023, 2005, 90 Stat. 1520. This “stepped-up” basis was equal to either the fair market value of such property on the date of the decedent’s death, or, if elected, the fair market value on the alternate valuation date provided in § 2032. I.R.C. § 1014(a). Section 2032 provides that, if elected, property distributed or sold within six months after the decedent’s death shall be valued as of the date of the distribution or sale. Property not distributed or sold within six months after the decedent’s death shall be valued as of the date six months after the decedent’s death. I.R.C. § 2032.


32. Id.; Castruccio, supra note 14, at 468. See also HOUSE COMM. ON WAYS AND MEANS & SENATE COMM. ON FINANCE, 91ST CONG., 1ST SESS., TAX REFORM STUDIES AND PROPOSALS, U.S. TREASURY DEPARTMENT pt. 3, at 334 (Comm. Print 1969)
far beyond the time otherwise dictated by prudent investment considerations. As a result of the "stepped-up" basis provision, property owners were encouraged to retain their property and pass it on to their beneficiaries with a "stepped-up" basis rather than dispose of it by sale and incur heavy gains taxes on the property's appreciated value. The effect of this "lock-in" phenomenon was immobilization of investment positions and encumbrance of capital flow.

The "stepped-up" basis provision was further criticized for causing a substantial loss of revenue to the Treasury. By providing property acquired from a decedent a step-up in basis equal to its fair market value on the date of the decedent's death, all appreciation in the value of such property occurring between the decedent's acquisition of the property and the date of death permanently escaped federal income taxation. The appreciated value of such property was often substantial, so that the failure to tax resulted in a sizeable loss of revenue to the Treasury.

The third major criticism of the "stepped-up" basis provision centered on the fact that it was inequitable when compared with the basis treatment accorded other types of transfers. As a consequence of receiving a "stepped-up" basis, any appreciation in the value of property that occurred while such property was in the decedent's hands was never subject to federal income taxation. The basis treatment accorded property acquired by gift and property sold during one's lifetime did not allow for such a windfall. In light of the fact that acquisition of property from a decedent and acquisition of property by inter vivos gift both resulted from gratuitous transfers, there

[hereinafter cited as TAX REFORM STUDIES]; Covey, Possible Changes in the Basis Rule for Property Transferred by Gift or at Death, 50 TAXES 831, 831-32 (1972) [hereinafter cited as Covey]; Heckerling, supra note 6, at 253; Slawson, Taxing as Ordinary Income the Appreciation of Publicly Held Stock, 76 YALE L.J. 623, 644 (1967).

33. Taxing Appreciated Property, supra note 31, at 364. The external factors are the high capital gains tax incurred upon sale of the property and the prospect of avoiding this gains tax through the "stepped-up" basis provision. See Castruccio, supra note 14, at 468; Heckerling, supra note 6, at 253-54.

34. See Waterbury, supra note 18, at 48; Taxing Appreciated Property, supra note 31, at 365. See also TAX REFORM STUDIES, supra note 32, at 334; Heckerling, supra note 6, at 247, 253.

35. See TAX REFORM STUDIES, supra note 32, at 334; Heckerling, supra note 6, at 253.


37. See notes 8 to 10 and accompanying text supra.

38. It is estimated that over $15 billion in income went untaxed each year as a result of the step-up in basis at death. 122 CONG. REC. H10,227 (daily ed. Sept. 16, 1976) (remarks of Rep. Ullman). According to a Senate Budget Committee study, the failure to tax gain at death cost the Treasury between $6 billion and $7 billion a year. Andrews, Tax Reform Act to Make Dec. 31 Landmark Date, N.Y. Times, Dec. 29, 1976, at 37, col. 1.

39. See Heckerling, supra note 6, at 249; Taxing Appreciated Property, supra note 31, at 364, 367-68.

40. See Stansbury & Blazek, supra note 8, at 14.

41. Id.
appeared to be no logical reason why at least these two types of property were not treated alike for the purpose of determining basis.\(^\text{42}\) These criticisms in turn became the source of much debate.\(^\text{43}\) Supporters of the “stepped-up” basis provision and advocates of reform challenged the validity of the “lock-in” theory, the major economic argument proffered against the “stepped-up” basis provision.\(^\text{44}\) They claimed that there was little empirical evidence that the tax forgiveness\(^\text{45}\) aspect of the “stepped-up” basis provision encouraged the retention of property.\(^\text{46}\) It was argued that the group most actively engaged in estate planning was middle aged investors for whom tax forgiveness for the appreciated value of property at death was a remote future tax benefit, and not likely to be considered in their planning.\(^\text{47}\)

Those who advocated retention of the “stepped-up” basis provision contended that the appreciated value of property acquired from a decedent did not totally escape taxation because the unrealized appreciation was subject to an estate tax imposed on the appreciated value of the property.\(^\text{48}\) This argument was offered to refute both the criticism of disparity in treatment between transfers of property at death and other transfers, and the criticism of loss of revenue.\(^\text{49}\) In addition, it was argued that the “stepped-up” basis provision was advantageous because of its simplicity:\(^\text{50}\) it made the decedent’s basis irrelevant upon death and thereby alleviated the problems of determining basis.\(^\text{51}\)

These arguments in favor of the “stepped-up” basis provision, however, did little to stem the tide of demands for reform.\(^\text{52}\) These demands were accompanied by proposals advocating two alternative types of basis treatment to replace the “stepped-up” basis provision: taxation of unrealized appreciation at death\(^\text{53}\) and application of the “carryover” basis treatment.
property acquired by inter vivos gift.\textsuperscript{54} Numerous bills were drafted to revise the basis treatment accorded property acquired from a decedent;\textsuperscript{55} however, prior to the ratification of section 1023 of the Tax Reform Act of 1976,\textsuperscript{56} none received sufficient congressional support to be enacted into law.

\textsuperscript{54} The "carryover" basis alternative was first advanced in 1942 by Randolph Paul as a compromise between taxing the appreciated value of property at death and retention of the "stepped-up" basis rule. \textit{See} \textit{Hearings on Revenue Revision of 1942 Before the House Comm. on Ways and Means}, 77th Cong., 2d Sess., pt. 1, at 90 (1942). \textit{See also} Heckerling, \textit{supra} note 6, at 249, 261-62.

\textsuperscript{55} In reference to proposals recommending that property acquired from a decedent be accorded a "carryover" basis, see, for example, Tydings Amendment, 91st Cong., 1st Sess., 115 \textit{Cong. Rec.} 37,305-10 (1969); H.R. 11058, 92d Cong., 1st Sess. \S 113 (1971) (reintroduced in 1972 as H.R. 13857, 92d Cong., 2d Sess.); H.R. 5250, 91st Cong., 1st Sess. (1969). For a discussion of these proposals, see Covey, \textit{supra} note 32, at 833-37.

\textsuperscript{56} Tax Reform Act of 1976, Pub. L. No. 94-455, \S\S 1023, 2005, 90 Stat. 1520 (amending I.R.C. \S\S 1014 (1954)). Section 1023 of the Tax Reform Act of 1976 had its origin in H.R. 14844, the proposed Estate and Gift Tax Reform Act of 1976. H.R. REP. No. 1380, 94th Cong., 2d Sess. 36-46, \textit{reprinted in} [1976] U.S. CODE CONG. & AD. NEWS 3356, 3390-400. Section 1023 of H.R. 14844 provided a "carryover" basis for property acquired from a decedent in lieu of the "stepped-up" basis provided by I.R.C. \S 1014. \textit{Id.} at 37, \textit{reprinted in} [1976] U.S. CODE CONG. & AD. NEWS 3356, 3391. H.R. 14844 essentially provided the same "carryover" basis for property acquired from a decedent as that provided in section 1023 of the Tax Reform Act of 1976, with the exception that H.R. 14844 did not include the "fresh-start" provision. \textit{See} note 72 \textit{infra}. H.R. 14844 was reported to the House by the Committee on Ways and Means, but rather than reviewing H.R. 14844, the House considered and passed H.R. 10612. H.R. REP. No. 1380, 94th Cong., 2d Sess. 1, \textit{reprinted in} [1976] U.S. CODE CONG. & AD. NEWS 3356. In the Conference Committee's report on H.R. 10612, the Committee's recommendations closely paralleled the provisions contained in H.R. 14844 with regard to according property acquired from a decedent a "carryover" basis. S. CONF. R. No. 1236, 94th Cong., 2d Sess. 611-13, \textit{reprinted in} [1976] U.S. CODE CONG. & AD. NEWS 4246, 4250-52. However, the Conference Committee added one significant modification to the "carryover" basis provision proposed by H.R. 14844: a "fresh-start" modification allowing an increase in the decedent's adjusted basis in property held by the decedent on December 31, 1976, to such property's fair market value on
Section 1023 of the Tax Reform Act of 1976 provides that:

[except as otherwise provided in this section, the basis of carryover basis property acquired from a decedent dying after December 31, 1976, in the hands of the person so acquiring it shall be the adjusted basis of the property immediately before the death of the decedent, further adjusted as provided in this section.]  

The effect of this provision is to accord property acquired from a decedent a "carryover" basis, subject to certain modifications, irrespective of the property's actual value as reflected in the decedent's federal estate tax return. The foundation of the "stepped-up" basis provision — a step-up in federal income tax basis to the property's fair market value at the date of the decedent's death or alternate valuation date — has thereby been
eliminated in most instances as the primary ingredient determining the basis of property acquired from a decedent.\(^6\)

The "carryover" basis provisions of section 1023 are applicable only to property defined as "carryover basis property."\(^6\)\(^3\) "Carryover basis property" is defined as "any property which is acquired from or passed from a decedent (within the meaning of section 1014(b)) and which is not excluded pursuant to paragraph (2) or (3)."\(^6\)\(^4\) Property acquired from or passing from a decedent as defined in section 1014(b) includes, principally, "property acquired by bequest, devise, or inheritance, and, in the case of decedents dying after December 31, 1953, property required to be included in determining the value of the decedent's gross estate."\(^6\)\(^5\) This definition is broad enough to include most types of property acquired from a decedent. However, certain kinds of property are specifically excluded from the term "carryover basis property."\(^6\)\(^6\) These exclusions include: income in respect of a decedent, as defined in section 691 of the Code; proceeds of life insurance; certain joint and survivor annuities and payments received under certain deferred compensation plans; property included in an estate but which has been disposed of by the transferee prior to the donor's death in a transaction in which gain or loss was recognized; stock or stock options to the extent income is includable in gross income; and property relating to foreign personal holding companies.\(^6\)\(^7\) In addition, any asset that was a personal or household effect in the hands of the decedent and for which the executor of the decedent's estate has made the proper election, is excluded from the term "carryover basis property."\(^6\)\(^8\) This exclusionary provision is limited by the proviso that the fair market value of all the elected assets shall not exceed $10,000.\(^6\)\(^9\) Those assets, excluded from "carryover" basis treatment under this provision, receive a "stepped-up" basis to their fair market value at the date of the decedent's death or the alternate valuation date.\(^7\)\(^0\)

The "carryover" basis provision provides four possible adjustments to the decedent's adjusted basis.\(^7\)\(^1\) The initial allowable adjustment to the

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62. The "carryover" basis provision of section 1023 only applies to property defined as "carryover basis property." Property falling outside the definition of "carryover basis property" will continue to be accorded a "stepped-up" basis.
64. Id. §1023(b)(1).
67. Id. §1023(b)(2).
68. Id. §1023(b)(3)(A).
69. Id. §1023(b)(3)(B).
70. See Stansbury & Blazek, supra note 8, at 14.
71. Tax Reform Act of 1976, Pub. L. No. 94-455, §1023(c)-(e), (h), 90 Stat. 1520 (amending I.R.C. §1014 (1954)). The starting point for determining the basis of property acquired from a decedent after December 31, 1976, is the decedent's adjusted basis in such property. If the decedent's adjusted basis is unknown, §1023(g)(3) provides for its determination: the basis will be deemed to be the fair market value of the property as of the date or approximate date at which such property was acquired.
The "fresh-start" rule provides that, for purposes of determining gain, any asset considered held by the decedent on December 31, 1976, shall receive a step-up in basis to its fair market value on December 31, 1976. Section 1023 contains mandatory valuation rules for determining the fair market value of the decedent's adjusted basis is provided by the "fresh-start" rule. The "fresh-start" rule provides that, for purposes of determining gain, any asset considered held by the decedent on December 31, 1976, shall receive a step-up in basis to its fair market value on December 31, 1976. The "fresh-start" adjustment, if available, is to be made before any other adjustment to the decedent's adjusted basis. The "fresh-start" adjustment reflects a compromise between those members of Congress who opposed any revision of the "stepped-up" basis provision and those members who wanted to accomplish a complete revision. The "carryover" basis provision contained in H.R. 14844 did not include this provision and would have accorded property acquired from a decedent essentially the same basis treatment accorded property acquired by *inter vivos* gift, with the exception that: the carryover basis of property acquired from a decedent could be increased for federal and state estate taxes; there would be a $60,000 minimum basis provision; and the carryover basis could be increased for succession taxes paid by the recipient of the property. See H.R. REP. No. 1380, 94th Cong., 2d Sess. 36-46, reprinted in [1976] U.S. CODE CONG. & AD. NEWS 3356, 3390-400. In order to effect passage of the "carryover" basis provision and to achieve equity with respect to those who had relied on the "stepped-up" basis provision in their estate planning, the Conference Committee adopted the "carryover" basis provision embodied in House bill H.R. 14844, with one modification: that "the adjusted basis of property which the decedent is treated as holding on December 31, 1976, is increased for purposes of determining gain (but not loss), by the amount by which the fair market value of property on December 31, 1976, exceeds its adjusted basis on that date." S. CONF. R. No. 1236, 94th Cong., 2d Sess. 612, reprinted in [1976] U.S. CODE CONG. & AD. NEWS 4246, 4251. As a result of the December 31, 1976, "fresh-start" rule, the changes implemented by the "carryover" basis provision will have a minimal impact in the near future. Andrews, *Tax Reform Act to Make Dec. 31 Landmark Date*, N.Y. Times, Dec. 29, 1976, at 37, col. 1. The "fresh-start" adjustment is not allowed if a subsequent sale of the property is for less than the decedent's adjusted basis in the property. If a subsequent sale of the property is for less than the decedent's adjusted basis in the property, then the decedent's adjusted basis may only be increased by the other allowable adjustments contained in §1023. Section 1023(h) provides for an increase in the decedent's adjusted basis if the December 31, 1976 value exceeds the decedent's adjusted basis. Therefore, if the fair market value of the property on December 31, 1976, is less than the decedent's adjusted basis, there is no step-down in basis to the December 31, 1976 value and the proper basis for determining gain on a subsequent sale is the decedent's adjusted basis. Id. §1023(h).

Section 1023(h) does not include a provision limiting the "fresh-start" increase to the estate tax value of the property. Id. The Conference agreement, however, stated that "the basis cannot be increased above its estate tax value." S. CONF. R. No. 1236, 94th Cong., 2d Sess. 612, reprinted in [1976] U.S. CODE CONG. & AD. NEWS 4246, 4251. This limitation was consistent with the limitation imposed on the adjustments to the decedent's basis allowed under H.R. 14844 for federal and state estate taxes paid, for a $60,000 minimum basis in all "carryover basis property," and for state succession and inheritance taxes paid by the recipient of the decedent's property. See H.R. REP. No. 1380, 94th Cong., 2d Sess. §1023(f)(1), at 87 (Comm. Print 1976). This is the only provision of major importance that was contained in the Conference agreement, S.
property on December 31, 1976. Two distinct valuation rules are established by the "carryover" basis provision: one for property defined as marketable bonds and securities, and another for all other property. With regard to marketable bonds and securities, the normal methods of valuation for estate and gift tax purposes are to be used in determining their fair market value on December 31, 1976. For all property other than marketable

CONF. R. No. 1236, 94th Cong., 2d Sess. 607, reprinted in [1976] U.S. CODE CONG. & AD. NEWS 4246, and not included in §1023 of the Tax Reform Act of 1976, Pub. L. No. 94-455, §1023, 90 Stat. 1520 (amending I.R.C. §1014 (1954)). As a result of this omission, even if the estate tax value of the property on the date of the decedent's death is less than its value on December 31, 1976, the property is accorded a "fresh-start" basis equal to its December 31, 1976 value. The other allowable adjustments to the decedent's adjusted basis contained in §1023 are limited by the fair market value of the property. Tax Reform Act of 1976, Pub. L. No. 94-455, §1023(f)(1), 90 Stat. 1520 (amending I.R.C. §1014 (1954)). Section 1023(g)(1) defines fair market value as the estate tax value of the property, and therefore all adjustments to the decedent's adjusted basis, except the "fresh-start" adjustment, are limited by its estate tax value. See id. §1023(f)(1), (g)(1). The Conference agreement intended to subject the "fresh-start" adjustment to the same estate tax value limitation. An amendment to §1023 could remedy this situation, which seems to have been caused by an oversight in drafting the "fresh-start" provision. The deficiency could easily be corrected by the addition of a reference to subsection (h) in §1023(f)(1), which would then provide, "[t]he adjustments under subsections (c), (d), (e), and (h) shall not increase the basis of property above its fair market value." Id. §1023(f)(1).

75. Id. §1023(h)(1). For the valuation of marketable bonds or securities, §1023(h)(2)(E)(i) defines the term as meaning "any security for which, as of December 1976, there was a market on a stock exchange, in an over-the-counter market, or otherwise." Id. §1023(h)(2)(E)(i). This definition is not as explicit as the definition given by the Conference agreement. The Conference agreement defined marketable bonds or securities as, securities which are listed on the New York Stock Exchange, the American Stock Exchange, or any city or regional exchange in which quotations appear on a daily basis, including foreign securities listed on a recognized foreign national or regional exchange; securities regularly traded in the national or regional over-the-counter market, for which published quotations are available; securities locally traded for which quotations can readily be obtained from established brokerage firms; and units in a common trust fund:

S. CONF. R. No. 1236, 94th Cong., 2d Sess. 613, reprinted in [1976] U.S. CODE CONG. & AD. NEWS 4246, 4253. The use of the term "or otherwise" in §1023 of the Tax Reform Act of 1976 allows for the broader definition of what is a marketable bond and security for purposes of the "fresh-start" rule than that espoused by the Conference Committee, and in all likelihood this definitional problem will be clarified when the Treasury issues regulations pertaining to §1023.


Although §1023(h) of the Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520 (amending I.R.C. §1014 (1954)), does not specifically provide that, with regard to
bonds and securities, a mandatory daily basis formula is provided by section 1023 in order to avoid the problem of appraising such property’s fair market value on December 31, 1976. The use of this special valuation rule is mandatory even though the executor or beneficiary of the decedent can establish that the fair market value of the property on December 31, 1976 is different than the value determined under the special valuation method, and is premised on the notion “that any appreciation occurring since the acquisition of the property until the date of the decedent’s death occurred at the same rate over the entire time that the decedent is treated as holding the property.”

The second allowable adjustment to the decedent’s adjusted basis is an increase for federal and state estate taxes paid by the estate. The basis of each asset is increased by the amount of federal and state estate taxes attributable to the amount of appreciation inherent in the asset.

marketable bonds and securities, the normal methods of valuation for estate and gift tax purposes are to be used in determining their fair market value on December 31, 1976, it is the common method of valuation and will be utilized for the “fresh-start” adjustment. Under the usual rules applicable for estate tax purposes, the December 31, 1976 value for a marketable bond or security will be, “the mean between the high and low for trading securities, or bid price (net asset value) for mutual funds, or quotations from brokers for municipal bonds.” Stansbury & Blazek, supra note 8, at 15.

78. Tax Reform Act of 1976, Pub. L. No. 94-455, § 1023(h)(2), 90 Stat. 1520 (amending I.R.C. § 1014 (1954)). Section 1023(h)(2) provides that the decedent’s adjusted basis will be increased by the portion of the total appreciation in value for the entire holding period prior to death allocable to the period prior to January 1, 1977, with such allocation made on a daily basis. Id. Adjustments are required for depreciation, amortization or depletion recognized in connection with the asset. Id. The following formula clarifies the method to be used in determining the appropriate “fresh-start” basis for any asset that is not a marketable bond or security; [number of days in holding period prior to Jan. 1, 1977, divided by the number of days in the holding period] times [value on date of death minus decedent’s actual basis minus depreciation, amortization or depletion for holding period] plus [depreciation, amortization or depletion for holding period prior to Jan. 1, 1977]. Stansbury & Blazek, supra note 8, at 15. See also Abbin, Daskal & Carlson, supra note 3, at 743-44.


81. Tax Reform Act of 1976, Pub. L. No. 94-455, § 1023(c), 90 Stat. 1520 (amending I.R.C. § 1014 (1954)). This adjustment is available for all “carryover basis property.” If the property is subject to the “fresh-start” adjustment, the increase in basis for estate taxes paid by the estate is the second allowable adjustment. However, if the property was acquired by the decedent on or after January 1, 1977, the initial allowable adjustment to the decedent’s basis will be for estate taxes paid by the estate, subject to the fair market value limitation. See note 82 infra.

82. Tax Reform Act of 1976, Pub. L. No. 94-455, § 1023(c), 90 Stat. 1520 (amending I.R.C. § 1014 (1954)). This adjustment in the basis of “carryover basis property” is not allowed if the decedent’s adjusted basis in such property, including any adjustment
Following the “fresh-start” adjustment, if available, and the adjustment for federal and state estate taxes, the decedent’s adjusted basis may be further increased if $60,000 exceeds the aggregate basis of all “carryover basis property.” If this adjustment is available, the basis of each carryover asset is increased so as to provide a minimum basis for all “carryover basis property” of $60,000.

The final adjustment allowable to the decedent’s adjusted basis is for certain state succession or inheritance taxes paid by the recipient of the decedent’s property. This adjustment is available only if the preceding allowable adjustments have not increased the asset’s basis above its fair market value.

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made under the “fresh-start” rule, is greater than the estate tax value of the property. Id. § 1023(c), (f)(1). See note 73 supra.

The following formula will aid in the determination of the appropriate adjustment to the decedent’s adjusted basis for federal and state estate taxes: [net appreciation of asset divided by the fair market value of all property subject to tax] times [total estate and inheritance taxes paid by estate]. Stansbury & Blazek, supra note 8, at 15. See also Abbin, Daskal & Carlson, supra note 3, at 745. For purposes of determining the federal and state estate tax adjustment, “net appreciation” is a variable defined in § 1023(f)(2), Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520 (amending I.R.C. § 1014 (1954)). “Net appreciation” is the difference between the fair market value of property and the decedent’s adjusted basis in such property. Id. In some instances, the decedent’s adjusted basis will have been previously adjusted under the “fresh-start” rule. Therefore, “net appreciation” would be the difference between the fair market value of property and the decedent’s adjusted basis, as increased by the “fresh-start” adjustment. Id.


84. Id. This adjustment is allowed only if $60,000 exceeds the aggregate basis of all “carryover basis property” after the “fresh-start” adjustment, if available, and the adjustment for federal and state estate taxes have been made. Id. § 1023(d)(1). The $60,000 minimum basis provision is further limited by the proviso that the adjustment under this section shall not increase the basis of property above its estate tax value. Id. §§ 1023(f)(1), (g)(1). See note 73 supra. Therefore, if the aggregate fair market value of all “carryover basis property” is less than $60,000, the adjustment providing a minimum basis is limited by the lower aggregate fair market value figure. If the “fresh-start” adjustment and the adjustment for federal and state estate taxes have increased the adjusted basis of all “carryover basis property” to its fair market value, then the minimum basis adjustment is not available.

If the minimum basis adjustment is available, the basis of each appreciated asset will be increased by the amount determined by the following formula: [net appreciation in value of asset divided by net appreciation in value of all carryover basis property] times [$60,000 minus aggregate adjusted basis]. Stansbury & Blazek, supra note 8, at 15. For purposes of this formula, “net appreciation” and “aggregate adjusted basis” are determined after the “fresh-start” adjustment, if available, and the adjustment for federal and state estate taxes. Tax Reform Act of 1976, Pub. L. No. 94-455, § 1023(f)(2), 90 Stat. 1520 (amending I.R.C. § 1014 (1954)).

85. Tax Reform Act of 1976, Pub. L. No. 94-455, § 1023(e), 90 Stat. 1520 (amending I.R.C. § 1014 (1954)). This adjustment is only available if a recipient receives property from a decedent and pays succession or inheritance taxes with respect to such property for which the estate is not liable. Abbin, supra note 77, at 158.

86. Tax Reform Act of 1976, Pub. L. No. 94-455, § 1023(f)(1), 90 Stat. 1520 (amending I.R.C. § 1014 (1954)). Fair market value is defined as the property’s estate
In addition to the general provisions according "carryover basis property" acquired from a decedent the decedent's adjusted basis in such property, subject to four possible adjustments, section 1023 contains special rules concerning personal and household effects of a decedent.67 "Carryover basis property" that was a personal or household effect in the hands of a decedent cannot be accorded a basis in excess of its fair market value for purposes of determining loss on a subsequent sale of such property by its recipient.68 This provision removes personal and household effects of a decedent from the general "carryover" basis rule when such property is sold for a loss. If the decedent's adjusted basis in the property exceeds the property's fair market value, and the property is sold by its recipient for a loss, the recipient's basis in such property is limited by the property's fair market value. For purposes of determining gain on a subsequent sale, the general "carryover" basis rules apply to personal and household effects.69

In conjunction with the new basis rules embodied in section 1023, the Tax Reform Act of 1976 enacted section 6039A imposing special reporting requirements upon the executor of a decedent's estate.90 The Act now makes it obligatory for an executor to provide the Secretary of the Treasury and each person acquiring an item from the decedent certain information concerning the adjusted basis of such item.91 Failure to provide the
appropriate information to the Secretary and each recipient in the manner and at the times required by Treasury regulations will result in a penalty being assessed against the executor, unless it is shown that such failure was due to reasonable cause and not to willful neglect.  

EVALUATION OF THE CHANGE IN BASIS TREATMENT EFFECTED BY THE TAX REFORM ACT OF 1976

The proponents of the "carryover" basis provision recognized the fact that it basically worked a prospective change in the basis treatment accorded property acquired from a decedent. Despite this feature of the "carryover" basis provision, its proponents characterized it as a tax reform measure that not only constituted a significant advancement over prior law, but also as one that contributed significantly to the overall objectives of the Tax Reform Act of 1976.

In attempting to evaluate the success of the "carryover" basis provision in effecting a constructive change in the basis treatment accorded property acquired from a decedent, an examination of the provision's virtues as enunciated by members of Congress urging its adoption will be helpful. Representative Ullman, Chairman of the House Committee on Ways and Means, was a major proponent of the Tax Reform Act of 1976 in general, as well as the "carryover" basis provision revising the basis treatment accorded property acquired from a decedent. Representative Ullman stated that the Tax Reform Act of 1976 was a major effort to simplify the tax law, as well as to make it more equitable. Yet, the "carryover" basis provision

92. Id. § 6694. The penalty for not furnishing the Secretary with the required information is $100 for each such failure, but the total amount imposed for all such failures shall not exceed $5,000. Id. § 6694(a). The penalty for not furnishing the recipient of property the appropriate information is $50 for each such failure, but the total amount imposed for all such failures shall not exceed $2,500. Id. § 6694(b).


94. See notes 6 to 10 & 30 and accompanying text supra for a discussion of the basis treatment accorded property acquired from a decedent under prior law.

95. See 122 CONG. REC. H10,263 (daily ed. Sept. 16, 1976) (remarks of Rep. Ullman). In reference to the "carryover" basis provision's importance as part of the total tax reform package, Representative Ullman stated: "The compromise that we bring back to the Members on the 'stepped-up' basis problem is, I think, the centerpiece of this legislation." Id. See also id. at H10,229–30 (remarks of Rep. Rostenkowski).


97. 122 CONG. REC. H10,225 (daily ed. Sept. 16, 1976) (remarks of Rep. Ullman). Simplicity and equity were also goals of H.R. 14844, the forerunner of many of the estate and gift tax provisions contained in the Tax Reform Act of 1976, including the "carryover" basis provision. H.R. REP. NO. 1380, 94th Cong., 2d Sess. 5, reprinted in [1976] U.S. CODE CONG. & AD. NEWS 3356, 3359. Although H.R. 14844 did not include the "fresh-start" adjustment, it was significantly more complex than the "stepped-up" basis provision. In its initial form, the "carryover" basis provision of H.R. 14844, in contrast with the then existing "stepped-up" basis provision, still required a multitude of adjustments based on the decedent's adjusted basis in property not required by the
contained in the Tax Reform Act is the antithesis of simplicity and therefore must be viewed as failing dismally to satisfy a major objective of the Act, the simplification of the tax law. 98 Under the Code's previous "stepped-up" basis provision, the determination of the basis of property acquired from a decedent was a simple matter because it automatically became the fair market value of the property on the date of the decedent's death. 99 The decedent's adjusted basis in the property was irrelevant. However, as a result of the change in basis treatment effected by the "carryover" basis provision, 100 the determination of the proper basis to be accorded property acquired from a decedent becomes a complex technical process. 101 The executor of a decedent's estate must first determine the decedent's adjusted basis in each asset that is considered "carryover basis property." 102 For all property acquired after December 31, 1976, the executor must then make the permissible adjustment calculations for each asset in order to determine the carryover basis for the asset in the hands of its recipient. 103 For all property that was considered a personal or household effect in the hands of the decedent, the executor must calculate the fair market value of such property so as to be able to exclude a limited amount of this property from "carryover" basis treatment. 104 In addition, for any asset held by the decedent on December 31, 1976, the executor must determine if the asset qualifies for a "fresh-start" basis. 105 If the asset does qualify for a "fresh-start," the executor must calculate and report two bases: the proper basis to be used in the event the property is subsequently sold for a loss, and the proper basis to be used in the event the property is subsequently sold for a gain. 106 The various basis calculations required by the "carryover" basis provision are extremely complex and time consuming. Not only is basis determination made more complex, but the whole estate administration process is more complicated, prolonged and costly than under previous

99. See notes 6 & 30 and accompanying text supra.
102. See note 71 supra.
103. See notes 81 to 86 and accompanying text supra.
104. See notes 68 to 69 and accompanying text supra. Additionally, for all property that was considered a personal or household effect in the hands of the decedent, the executor must calculate the fair market value of such property in the event that the property is subsequently sold for a loss. See notes 87 to 89 and accompanying text supra.
105. See notes 72 to 80 and accompanying text supra.
106. See note 73 supra. The Tax Reform Act of 1976, Pub. L. No. 94-455, § 6039A, 90 Stat. 1520, makes it obligatory for an executor to furnish the Internal Revenue Service and each person acquiring an item from a decedent information on the adjusted basis of each asset. The basis reporting requirement that is now imposed upon an executor is very stringent. See Stansbury & Blazek, supra note 8, at 16, for a full discussion of the reporting requirement.
The executor's responsibilities are increased by the necessity of computing a "carryover" basis, and new difficulties in estate administration are created as a result of the "carryover" basis provision. The cumulative effect of the "carryover" basis provision is to add complexities and burdens on the administration of estates that did not exist under the "stepped-up" basis provision.

Closely associated with Congress' desire to simplify the tax laws was its desire to make them more equitable. Representative Ullman specifically stated that the estate and gift tax laws were far too inequitable and encouraged support of the "carryover" basis provision as a remedy to a major source of tax avoidance for high income people — the step-up in basis at death. The tax avoidance aspect of the "stepped-up" basis provision has been criticized by others because of the disparity this basis treatment created when compared with the "carryover" basis treatment accorded property acquired by inter vivos gift. The "carryover" basis provision contained in section 1023 does narrow the disparity between the basis treatment accorded property acquired from a decedent and property acquired by inter vivos gift, although in most instances this is accomplished.

107. See Abbin, Daskal & Carlson, supra note 3, at 745-46.
108. See notes 71 to 89 and accompanying text supra.
109. The executor, after collecting the assets, must estimate the burden of administration expenses and taxes and select the assets that should be sold in order to meet the burden of those payments. Under prior law, since property received a "stepped-up" basis, considerations of basis for determining gain or loss upon sale were not major factors in the executor's decision concerning which assets should be sold, since only a minimal gain or loss (if any) would result upon a sale by the executor. However, as a result of the "carryover" basis provision, there must now be an analysis of the basis of assets to be sold for such purposes since the sale of low-basis assets will generate capital gains taxes requiring the sale of additional assets in order to meet that additional burden. Stansbury & Blazek, supra note 8, at 16.
110. In addition to the complexities and burdens added to the process of estate administration by the "carryover" basis provision, the new provision greatly complicates the process of estate planning and the fiduciary responsibilities of an executor. Estate planning under the "stepped-up" basis rules was relatively simple — high basis assets were disposed of by inter vivos gift or by sale while low basis assets were retained until death thereby receiving a tax free step-up in basis to the property's fair market value. See Stansbury & Blazek, supra note 8, at 18. And, normally, an executor did not have to consider the basis of an asset when determining which asset to select for distribution to a beneficiary since the "stepped-up" basis provision provided most assets with a basis equal to its fair market value on the date of the decedent's death. Additionally, an executor could sell some of the decedent's property either to provide cash for administration expenses or to satisfy pecuniary legacies without realizing a substantial amount of gain on the sale as a consequence of the "stepped-up" basis provision. With the passage of the "carryover" basis provision, this relatively simplistic approach to estate planning and administration has come to an end as a result of the enormous tax implications of receiving a "carryover" basis, as opposed to a "stepped-up" basis, for property acquired from a decedent.
112. Id. at H10,227.
113. See notes 39 to 42 and accompanying text supra.
prospectively. In most instances, property acquired after December 31, 1976, and subsequently transferred at death will be accorded the decedent's adjusted basis in the property. However, even with regard to property acquired after December 31, 1976, total equality in basis treatment is not achieved for these two methods of gratuitously transferring property. Section 1023 provides for a $60,000 minimum basis for all “carryover basis property,” a benefit that has no counterpart in the basis treatment accorded property acquired by \textit{inter vivos} gift. The major disparity still existing between these two types of transfers results from the “fresh-start” provision included in section 1023. Property held by a decedent on December 31, 1976, will receive a step-up in basis to its fair market value on December 31, 1976, a continuation of the “stepped-up” basis provision in modified form. As a consequence of this “fresh-start,” the present effect of the “carryover” basis provision is to continue to accord property acquired from a decedent a more favorable basis treatment than that accorded property acquired by \textit{inter vivos} gift.

Another major objective of the “carryover” basis provision was the production of revenue in order to finance the various estate and gift tax reductions provided in the Tax Reform Act of 1976. The “carryover” basis provision was designed to raise revenue, both as originally drafted in the House bill, H.R. 14844, as well as after the inclusion of the “fresh-start” provision. Yet with the addition of the “fresh-start” rule, the “carryover”

114. Tax Reform Act of 1976, Pub. L. No. 94-455, § 1023(a)(1), 90 Stat. 1520 (amending I.R.C. § 1014 (1954)). It must be remembered that the “carryover” basis provision only applies to “carryover basis property.” Any property not included in this term continues to receive a “stepped-up” basis. I.R.C. § 1014(d). See note 62 supra. The practical result is that most property acquired from a decedent will be subject to the “carryover” basis provision. See notes 63 to 67 and accompanying text supra.


117. See notes 72 to 80 and accompanying text supra.

118. Moreover, Representative Crane stated that any equity contained in the “carryover” basis provision was more than offset by its complication of tax law. 122 CONG. REC. H10,232 (daily ed. Sept. 16, 1976).

The “carryover” basis provision, as originally drafted in H.R. 14844, supra notes 56 & 72, was more successful in obtaining equity between lifetime transfers and transfers at death. The “carryover” basis provision contained in H.R. 14844 did not include the “fresh-start” adjustment. See notes 56 & 72. The inclusion of this adjustment was a compromise between opponents and proponents of the “stepped-up” basis provision. See 122 CONG. REC. H10,263 (daily ed. Sept. 16, 1976) (remarks of Rep. Ullman).


basis provision is unlikely to have any revenue impact for years.122 The
estate and gift tax cuts are estimated to amount to $1.5 billion per year when
fully phased in, which will occur over a five year period.123 As a result of the
inclusion of the “fresh-start” rule, the “carryover” basis provision is
expected to yield only $162 million by fiscal 1981.124 This amount is hardly
enough to offset the estate and gift tax cuts, and therefore the choice of this
“carryover” basis provision as a revenue producing device was a poor one.125

Although not advanced as an objective of the “carryover” basis
provision by those who advocated its inclusion in the Tax Reform Act of
1976, the problem of “lock-in” purportedly caused by the “stepped-up” basis
provision has been the major economic argument utilized by those
clamoring for a change in the basis treatment accorded property acquired
from a decedent.126 The House Committee on Ways and Means specifically
cited the “lock-in” effect as a problem that the “carryover” basis provision,
prior to the “fresh-start” modification, was intended to eliminate.127 For
those who hoped a revision in the basis treatment accorded property
acquired from a decedent would ameliorate the “lock-in” problem, the
“carryover” basis provision must be a disappointment. The “carryover”
basis provision provides no incentive for a person to sell his property during
his lifetime, and thereby realize gain to the extent that the property has
appreciated in value. There is no tax imposed upon the appreciated value of
property until it is sold, and so not only is a person encouraged to hold onto

122. Prior to the “fresh-start” modification, the “carryover” basis provision was
envisioned as having great potential for raising additional amounts of revenue in
order to offset various estate and gift tax cuts. See H.R. Rep. No. 1380, 94th Cong., 2d
basis provision was expected to raise nearly $500 million in 1981. It was estimated
that this provision would offset the revenue loss caused by the estate and gift tax cuts
within 18 to 20 years. Id.

However, with the inclusion of the “fresh-start” adjustment in the “carryover”
basis provision, the provision will have little revenue impact for years. Andrews, Tax
Reform Act To Make Dec. 31 Landmark Date, N.Y. Times, Dec. 29, 1976, at 37, col. 1:
“Official estimates put the revenue yield at less than $5 million for fiscal 1977 and
1978, growing to $162 million by fiscal 1981. The long-run estimate is $1.08 billion a
year, perhaps two decades from now.”
29, 1976, at 37, col. 1.

125. Representative Ullman stated that over $15 billion of income went entirely
untaxed each year because of the step-up in basis at death. 122 Cong. Rec. H10,227
“carryover” basis to tax this income is questionable since any tax on the appreciated
value of property accorded a “carryover” basis is deferred until the recipient of such
property sells it. See note 8 and accompanying text supra. See also note 14 and
accompanying text supra. With the inclusion of a “fresh-start” as of December 31,
1976, the prospect of collecting large amounts of revenue is further decreased.

126. For a discussion of the “lock-in” effect and the “stepped-up” basis provision,
see notes 32 to 35 and accompanying text supra.
property and pass it on to beneficiaries at death, but the recipient of such property is discouraged from selling it because he must realize the appreciated value of the property, including appreciation that occurred while the decedent held the property. Under the "stepped-up" basis provision, any "lock-in" effect dissipated upon the decedent's death because the property was accorded a basis equal to its fair market value.\footnote{128} To the extent that the "lock-in" theory is valid, the effect of the "carryover" basis provision is to create an added incentive for people acquiring property from a decedent to retain such property.\footnote{129}

The "carryover" basis provision contained in the Tax Reform Act of 1976 must be considered a failure when measured against the general goals of the Act. The provision greatly complicates the tax law, and what equity is achieved by the "carryover" basis provision is more prospective than immediate, and therefore, more than offset by the added burdens placed upon the executor of a decedent's estate. The "carryover" basis provision also fails to accomplish the main purpose for which it was enacted, the raising of large amounts of revenue to offset the loss resulting from the large estate and gift tax reductions enacted to provide relief to small and medium-sized estates.

**CONCLUSION**

At first glance, the "carryover" basis provision in section 1023 truly appears to be an example of tax reform gone awry.\footnote{130} In its zeal to reform the basis treatment accorded property acquired from a decedent, Congress seems to have taken a "reform at any cost" approach. Perhaps this approach evolved because all previous attempts at reform had failed,\footnote{131} and therefore only a compromise proposal that placated supporters of the "stepped-up" basis provision could successfully be pushed through Congress.\footnote{132} Nevertheless, this "reform at any cost" approach has resulted in the adoption of a basis provision that portends frightening consequences for estate planning and administration.\footnote{133}

Query whether the inroad made by section 1023 in attaining equity in the basis treatment accorded property acquired through gratuitous transfers

\footnote{128. The "lock-in" effect occurred while the property was in the hands of the decedent. See note 34 and accompanying text supra.}

\footnote{129. The "carryover" basis provision was opposed by some members of Congress on the grounds that it would accentuate rather than eliminate the problem of "lock-in." See 122 Cong. Rec. H10,229 (daily ed. Sept. 16, 1976) (remarks of Rep. Schneebeli); id. at H10,232 (remarks of Rep. Conable).}

\footnote{130. When a provision fails to remedy the deficiencies of its predecessor and, even worse, accentuates some of those deficiencies and creates new problems, the new provision is susceptible to being labeled "tax reform gone awry." For a discussion of the changes effected by section 1023, see notes 93 to 129 and accompanying text supra.}

\footnote{131. See notes 52 to 56 and accompanying text supra.}


\footnote{133. For a discussion of the added burdens placed upon estate planners and administrators, see notes 99 to 110 and accompanying text supra.}
is worth sacrificing the simplicity that the "stepped-up" basis provision offered. From the estate planners' and administrators' point of view, the answer to this question must surely be No. Nevertheless, section 1023 does constitute an important advance in tax reform. The "stepped-up" basis provision remained virtually unaltered since the beginning of the federal income tax system.134 This provision's modification was always a major goal of tax reformers, and yet the "stepped-up" basis provision repeatedly withstood attacks by such reformers both inside and outside Congress.135

The original "carryover" basis provision proposed by H.R. 14844 envisioned an immediate change in the basis treatment accorded property acquired from a decedent.136 Under this bill, property acquired by a decedent before, as well as after, December 31, 1976, and subsequently acquired by a beneficiary upon the decedent's death, would have received a "carryover" basis similar to that accorded property acquired by inter vivos gift.137 Although the "carryover" basis provision contained in H.R. 14844 was much better suited than section 1023 to promote the desired goals of simplicity and equity, that proposal, as others before it, would probably have died in Congress had the "fresh-start" modification not been added by the Conference Committee.138 The "fresh-start" modification caused many of the reform aspects of section 1023 to become prospective in nature;139 in the future, those aspects of section 1023 that reform the "stepped-up" basis provision will be realized to a greater degree.140 Although the burdens

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134. See notes 28 to 30 and accompanying text supra.
135. See notes 52 to 56 and accompanying text supra.
136. See notes 56 & 72 supra.
137. Id.
139. With the "fresh-start" modification, the "carryover" basis provision works a gradual change in the basis treatment accorded property acquired from a decedent. For all "carryover basis property" held by a decedent on, or before, December 31, 1976, such property will be accorded a "fresh-start" as of its December 31, 1976 value. For a discussion of the "fresh-start" adjustment and its repercussions, see notes 72 to 80 & 93 and accompanying text supra.
140. As we move farther away from December 31, 1976, the amount of appreciation inherent in property acquired from a decedent that will totally escape federal income taxation as a result of the "fresh-start" provision will proportionately lessen. This will result in increased revenues — a major goal of the "carryover" basis provision. The disparity between the basis treatment accorded property acquired from a decedent and property acquired by inter vivos gift will also diminish since all property acquired by a decedent after December 31, 1976, and subsequently passed to beneficiaries at death, will receive the decedent's adjusted basis in the property without any significant step-up in basis. See note 114 and accompanying text supra. For property acquired by a decedent after December 31, 1976, and subsequently passed to beneficiaries at death, the only remaining inequity in the basis treatment accorded property acquired from a decedent is the $60,000 minimum basis provision. See note 115 and accompanying text supra.
currently placed upon estate planners and administrators seems unjustified, even under the guise of tax reform, many of the burdens result from the “fresh-start” modification\(^{141}\) — the provision that probably saved section 1023 from a fate identical to that of its predecessors. For those who considered revision of the “stepped-up” basis provision a major reform priority, the burdens presently placed upon estate planners and administrators are a necessary cost of elimination of the heretofore impervious concept of a “stepped-up” basis.\(^{142}\) Thus, despite dissatisfaction with the immediate impact of section 1023, it is hoped that, eventually, the goals achieved will justify its shortcomings.

141. The burdens placed upon estate planners and administrators as a result of the “fresh-start” provision range from problems of basis computation to decisions concerning which property to sell to satisfy administration expenses. See notes 72 to 80 & 99 to 110 and accompanying text supra. As we move farther away from December 31, 1976, there will be a decrease in the amount of property held by decedents on or before that date, and, therefore, we can expect a proportionate decrease in the burdens placed upon estate planners and administrators as a result of the “fresh-start” provision.