Part III. Administrative, Procedural, and Miscellaneous

Method for Making Election to Apply Carryover Basis Treatment under Section 1022 to the Estates of Decedents who Died in 2010 and Rules Applicable to Inter Vivos and Testamentary Generation-Skipping Transfers in 2010

Notice 2011–66

PURPOSE

This notice provides guidance with regard to the time and manner in which the executor of the estate of a decedent who died in 2010 elects, pursuant to section 301(c) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, P.L. 111–312 (124 Stat. 3296) (TRUIRJCA), to have the estate tax not apply and to have the carryover basis rules in section 1022 apply to property transferred as a result of the decedent's death. This notice also addresses how a donor may elect out of the automatic allocation of generation-skipping transfer (GST) tax exemption to direct skips occurring during 2010. It also clarifies the due dates for returns for the taxable year ending December 31, 2010, that report a generation-skipping transfer, that allocate GST exemption, or that opt out of the automatic allocation of GST exemption. In addition, the notice discusses the application of chapter 13 (the GST tax) to testamentary transfers during 2010. Finally, this notice addresses certain other collateral issues arising from the determination of basis under section 1022.

This notice applies to executors of the estates of decedents who died in 2010 and to recipients of property acquired from such decedents (within the meaning of section 1022(e)) (hereinafter, *acquired from the decedent*), if the executors make the election under section 301(c) of TRUIRJCA. This notice also applies to donors who made a gift during 2010 that is a generation-skipping transfer or an indirect gift for purposes of the GST tax. See Revenue Procedure 2011–41 for a safe harbor with regard to the interpretation and application of section 1022.

BACKGROUND

Subtitle A of title V of the Economic Growth and Tax Relief Reconciliation Act of 2001, P.L. 107–16 (EGTRRA) enacted section 2210, which made chapter 11 (the estate tax) inapplicable to the estate of any decedent who died in 2010 and chapter 13 (the GST tax) inapplicable to generation-skipping transfers made in 2010. On December 17, 2010, TRUIRJCA became law, and section 301(a) of TRUIRJCA retroactively reinstated the estate and GST taxes. However, section 301(c) of TRUIRJCA allows the executor of the estate of a decedent who died in 2010 to elect to apply the Internal Revenue Code (IRC) as though section 301(a) of TRUIRJCA did not apply with respect to chapter 11 and with respect to property acquired or passing from the decedent (within the meaning of section 1014(b)). Thus, section 301(c) of TRUIRJCA allows the executor of the estate of a decedent who died in 2010 to elect not to have the provisions of chapter 11 apply to the decedent's estate, but rather, to have the provisions of section 1022 apply (Section 1022 Election).

Even though an executor may elect out of the estate tax under TRUIRJCA, the provisions of chapter 13 (GST tax) nonetheless continue to apply. Section 302(c) of TRUIRJCA, however, provides that the applicable tax rate for each GST occurring during 2010 is zero. Section 301(d)(2) provides that, in the case of any generation-skipping transfer made after December 31, 2009, and before December 17, 2010, the due date for filing a return required under section 2662 of the IRC (including any election required to be made on such return) shall not be earlier than September 17, 2011.

TRUIRJCA also retroactively repealed section 2511(c), which treated each transfer in trust during 2010 as a gift unless the trust was treated as wholly owned by the donor or the donor's spouse. Because of this retroactive repeal, this section does not apply even if a Section 1022 Election is made.

GUIDANCE

I Section 1022 Election and Filing Requirements.

A. Section 1022 Election.

The executor of the estate of a decedent who died in 2010 may make the Section 1022 Election by filing a Form 8939, *Allocation of Increase in Basis for Property Acquired From a Decedent*, on or before November 15, 2011. Once made, the election is irrevocable except as provided in section I.D.1 or D.2 of this notice. Prior filings purporting to make the Section 1022 Election must be replaced with a timely filed Form 8939.

If, for the same decedent, the Internal Revenue Service (IRS) receives a Form 8939 and either a Form 706, *United States Estate (and Generation-Skipping Transfer) Tax Return*, or a Form 706–NA, *United States Estate (and Generation-Skipping Transfer) Tax Return Estate of Nonresident not a Citizen of the United States*, the IRS will issue a letter to each person who filed such a form. The letter will include the name and address of each person who filed a Form 706 (or Form 706–NA) or a Form 8939 with respect to the decedent, and will explain that each of those persons must collectively sign and file either a restated Form 706 (or Form 706–NA) or Form 8939 on or before 90 days from the date the IRS mails such letters. If no restated Form 706 (or Form 706–NA) or Form 8939, signed by each person who previously filed any such form, is filed within that 90-day period, the IRS will determine whether the executor has made a Section 1022 Election for the decedent's estate or whether the decedent's estate is subject to chapter 11. In making this determination, the IRS will consider all relevant facts and circumstances disclosed to the IRS, including without limitation the relative total fair market values of the decedent's property in the possession of the executors and the nature and significance of the economic impact of the Section 1022 Election (or its loss) on the beneficial owners of the property held by each executor. Some factors may be more relevant, and may be accorded more weight, than others for any particular estate.

B. Method to Allocate Basis.

The executor must allocate Basis Increase, as defined in section 4.02 of Revenue Procedure 2011–41, on a timely filed Form 8939. For purposes of this section, references to the term "executor" shall be construed in accordance with section 2203 as if that section was applicable. Accordingly, if an executor has been appointed, has qualified, and is acting for a decedent's estate within the United States, the IRS generally will only accept Forms 8939 filed by such executor.

If an executor has not been appointed, any person in actual or constructive possession of property acquired from the decedent may file a Form 8939 for the property he or she actually or constructively possesses. If the IRS receives multiple Forms 8939 that collectively purport to allocate Basis Increase in an amount greater than the amount of Basis Increase available to the estate, the IRS will issue a letter to each person who filed such a form. The letter will include the name and address of each other person who filed a Form 8939 with respect to the decedent, and will explain that each of those persons must collectively sign and file a single, restated Form 8939 allocating available Basis Increase in order to make the Section 1022 Election. The restated Form 8939 must be filed on or before 90 days from the date the IRS mails such letters. If no restated Form 8939, signed by each such person who previously submitted a Form 8939, is filed within that 90-day period, the IRS will allocate the available Basis Increase as the IRS, in its discretion, may determine. In making this determination and exercising its discretion, the IRS will consider all relevant facts and circumstances disclosed to the IRS. That allocation might be made on a *pro-rata* basis, based on the amount of unrecognized appreciation in the property owned by the decedent (within the meaning of section 1022(d)) (hereinafter, *owned by the decedent*) at death and acquired from the decedent that was reported on the timely filed Forms 8939, or in any other manner deemed appropriate for the particular decedent's estate by the IRS in the exercise of its discretion.

The recipient's basis in a particular property (including the amount of Basis Increase allocated to that property) is subject to adjustment upon the examination by the IRS of any tax return reporting a value dependent upon the property's basis (for example, the property's depreciation, sale, or other disposition that triggers gain or loss on the property, or otherwise).

C. Reporting Requirements.

If the executor makes the Section 1022 Election, the executor must report and value on Form 8939 all property (excluding cash and property that constitutes the right to receive an item of income in respect of a decedent under section 691 (IRD)) acquired from the decedent. Section 6018(b)(1). In addition, the executor also must report all appreciated property acquired from the decedent, valued as of the decedent's date of death, that was required to be included on the donor's Form 709, *United States Gift (and Generation-Skipping Transfer) Tax Return*, if such property was acquired by the decedent by gift or by *inter vivos* transfer for less than adequate and full consideration in money or money's worth during the 3-year period ending on the date of the decedent's death. Section 6018(b)(2). This does not include property transferred to the decedent by the decedent's spouse, who had not acquired the property in whole or in part by gift or by *inter vivos* transfer for less than adequate and full consideration in money or money's worth during that same 3-year period.

In the case of a deceased nonresident who is not a citizen of the United States, the property to be reported is limited to tangible property situated in the United States that is acquired from the decedent and any other property acquired from the decedent by a United States person. Section 6018 describes the information that must be provided on Form 8939.

In addition to the information as provided in this paragraph C, the executor must include with the Form 8939 any other information and supporting documentation as identified in the instructions to the Form 8939 or in any Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(*b*)).

Within 30 days after the executor files a timely filed Form 8939, the executor (or each executor filing such a form) must provide a statement to each recipient acquiring property reported on that form, setting forth the information required under section 6018(c), regardless of whether the executor allocates Basis Increase to such property on the form. Section 6018(e). If an adjustment is made to the basis of property reported on a Form 8939, the executor must provide updated statements to each recipient of property affected by that adjustment within 30 days after making the adjustment or receiving notice of the adjustment from the IRS, whichever is applicable.

D. Time for Filing Return.

1. In General.

Form 8939 is due November 15, 2011. A Form 8939 filed prior to that date may be amended or revoked, but only on a subsequent Form 8939 filed on or before November 15, 2011. The Form 8939 that is timely filed by an executor is the last Form 8939 filed by that executor on or before November 15, 2011. No executor's Form 8939 will have any effect on any Form 8939 filed by a different executor. The IRS will not grant extensions of time to file a Form 8939 and will not accept a Form 8939 or an amended Form 8939 filed after the due date, except as provided in section I.A or B (in the event of conflicting filings) or in section I.D.2 (regarding relief provisions) of this notice. Thus, a taxpayer may not file an estate tax return as well as a conditional Form 8939 that would take effect only if an estate tax audit results in an increase in the gross estate above the applicable exclusion amount. Notwithstanding the previous sentences, however, for persons qualifying under section 7508 or 7508A, the due date for filing a Form 8939 is postponed as provided in those sections. Any executor filing a Form 8939 after November 15, 2011, pursuant to section 7508 or 7508A should write "Filed Pursuant to Section 7508" or "Filed Pursuant to Section 7508A", as applicable, on the top of the form. The failure to write these notations at the top of the Form 8939, however, does not adversely impact the extension granted under section 7508 or 7508A. Furthermore, for decedents qualifying for relief under section 692, an executor must file a Form 8939 to make the Section 1022 Election.

2. Relief Provisions.

Four types of relief from the requirements of section I.D.1 of this notice are available. First, an amended Form 8939 may be filed after the due date of that form for the sole purpose of allocating Spousal Property Basis Increase, as that term is defined in section 1022(c)(2) and section 4.02(3) of Revenue Procedure 2011–41, among the property eligible to receive an allocation of that basis, provided that each of the two following requirements is satisfied. The first requirement is that the Form 8939 must have been timely filed and was complete when filed except for the allocation of the full amount of the Spousal Property Basis Increase to the eligible property reported on that Form 8939. The second requirement is that each amended Form 8939 must be filed no more than 90 days after the date of the distribution of the qualified spousal property to which Spousal Property Basis Increase is allocated on that amended Form 8939.

Second, provided an executor timely filed a Form 8939, the executor may file an amended Form 8939 under the provisions of § 301.9100–2(b) on or before May 15, 2012, for any purpose except to make or revoke a Section 1022 Election. The executor must write "Filed Pursuant to Section 301.9100–2" on the top of the amended Form 8939.

Third, an executor may apply for relief to supplement a timely filed Form 8939 under § 301.9100–3. A request for relief to supplement a timely filed Form 8939 is limited to an extension of time to allocate any Basis Increase that has not previously been validly allocated, and such relief, if appropriate, will be granted only if: (1) after filing the Form 8939, the executor discovers additional property to which remaining Basis Increase could be allocated; and/or (2) the fair market value of property reported on the Form 8939 is adjusted as the result of an IRS examination or inquiry. Relief will not be granted to reduce an allocation of Basis Increase made on a timely filed Form 8939.

Fourth, an executor may apply for relief under § 301.9100–3 in the form of an extension of the time in which to file the Form 8939 (thus, making the Section 1022 Election and the allocation of Basis Increase), which relief may be granted if the requirements of § 301.9100–3 are satisfied. Taxpayers should be aware, however, that, in this context, the amount of time that has elapsed since the decedent's death may constitute a lack of reasonableness and good faith and/or prejudice to the interests of the government (for example, the use of hindsight to achieve a more favorable tax result and/or the lack of records available to establish what property was or was not owned by the decedent at death), which would prevent the grant of the requested relief.

II GST Tax in 2010.

A. With Respect to Decedents Who Died in 2010

The GST tax was retroactively reinstated by TRUIRJCA and applies to the estates of all decedents who died after December 31, 2009, regardless of whether a Section 1022 Election is made. The GST tax is computed by multiplying the taxable amount by the applicable rate. Section 2602. Section 2641(a) defines the applicable rate for this purpose as the maximum federal estate tax rate applicable to the estate of a decedent dying at the time of the transfer, multiplied by the inclusion ratio with respect to that transfer. Section 302(c) of TRUIRJCA provides that, for each GST occurring during 2010, the applicable rate under section 2641(a) is zero. This provision is interpreted to mean that the maximum federal estate tax rate for purposes of computing the GST tax on such a transfer is deemed to be zero which, when multiplied by any inclusion ratio, will result in an applicable rate of zero. As under the law applicable to GSTs occurring prior to 2010, the only way to achieve a zero inclusion ratio for the transfer is to make a timely allocation of GST exemption to the transfer.

If the executor of a decedent who died in 2010 makes the Section 1022 Election, the executor allocates that decedent's available GST exemption by attaching the Schedule R of Form 8939 to the Form 8939 for that decedent's estate. If the Form 8939 is timely filed, this allocation will be considered a timely allocation of the decedent's GST exemption under section 2632.

B. *Inter Vivos* Direct Skips

In the case of *inter vivos* direct skips that occurred in 2010, if the donor wishes to pay GST tax at the rate of zero percent and therefore does not wish to have any GST exemption allocated to that transfer, the donor may elect out of the automatic allocation of GST exemption to that direct skip in either of two ways. First, the donor affirmatively may elect out of the automatic allocation by describing, on a timely filed Form 709, both the transfer and the extent to which the automatic allocation is not to apply. See section 26.2632–1(b)(1)(i). Alternatively, that same regulation also provides that, ". . . a timely-filed Form 709 accompanied by payment of the GST tax (as shown on the return with respect to the direct skip) is sufficient to prevent an automatic allocation of GST exemption with respect to the transferred property." Because it is clear that a 2010 transfer not in trust to a skip person is a direct skip to which the donor would never want to allocate GST exemption, the IRS will interpret the reporting of an *inter vivos* direct skip not in trust occurring in 2010 on a timely filed Form 709 as constituting the payment of tax (at the rate of zero percent) and therefore as an election out of the automatic allocation of GST exemption to that direct skip. This interpretation also applies to a direct skip not in trust occurring at the close of an estate tax inclusion period (ETIP) in 2010 other than by reason of the donor's death. However, a donor may or may not want to allocate GST exemption to a 2010 direct skip made to a trust. Therefore, this interpretation will not apply to any transfer in trust that is a direct skip or that occurs at the end of an ETIP. In addition, because this interpretation only applies to *inter vivos* direct skips, it will also not apply to any direct skip, or to the close of an ETIP, by reason of the donor's death. Section 26.2632–1(c)(4). The rules regarding the automatic allocation of GST exemption will apply to transfers described in the preceding sentence unless the transferor affirmatively elects to have those rules not apply.

C. Filing Deadlines

Section 2611(a) defines a GST transfer as a direct skip, a taxable distribution, or a taxable termination. An indirect skip, as defined in section 2632(c)(3), is not a GST transfer. Section 2631 provides that each individual is allowed a GST exemption amount which may be allocated to any property with respect to which such individual is the transferor. Under § 26.2632–1(b)(3) and (4), an election to treat a trust as a GST trust or to allocate GST exemption to any *inter vivos* transfer other than a direct skip, is made on a timely filed Form 709. Section 2632(b)(1) and (c)(1) provide that, if any individual makes a direct or indirect skip during life, any unused portion of such individual's GST exemption shall be allocated to the property transferred to the extent necessary to make the inclusion ratio for such property zero. Sections 2632(b)(3) and (c)(5) and § 26.2632–1(b)(1)(i) and (b)(2)(ii) provide that an individual may prevent the automatic allocation of GST exemption by so providing on a timely filed Form 709.

Section 301(d)(2) of TRUIRJCA extends the time for filing any return required under section 2662 (including any election required to be made on such return) to report a GST transfer made after December 31, 2009, and before December 17, 2010, to September 17, 2011. Accordingly, the due date for filing a return reporting a direct skip, a taxable distribution, or a taxable termination (including any election required to be made on such return) that occurred on or after January 1, 2010, through December 16, 2010, is September 19, 2011, including extensions (because September 17, 2011, falls on a Saturday), except in the case of a Schedule R attached to Form 8939, which is due on or before November 15, 2011.

However, the language of Section 301(d)(2) of TRUIRJCA does not extend the due date of all gift and GST returns for 2010. Specifically, to the extent a return relates to an indirect skip, or to a post-December 16, 2010, direct skip, the due date of the return is not extended. Thus, the due date for filing a Form 709 that does not report a GST transfer or that reports a GST transfer (or any election pertaining to such transfer) that occurs on or after December 17, 2010, through December 31, 2010, was April 18, 2011, including extensions. In addition, the due date for filing a Form 709 to elect to treat a trust as a GST trust or to allocate GST exemption to a transfer occurring during 2010 under § 26.2632–1(b)(3) or (4) was April 18, 2011, including extensions. However, if a donor timely filed Form 709 for the taxable year ending December 31, 2010, but failed to allocate GST exemption to a transfer occurring during such year, see § 301.9100–2 for possible relief.

D. Application of Chapter 13 to Testamentary Transfers During 2010

For purposes of chapter 13, the Treasury Department and IRS will construe and apply any reference to chapter 11 without regard to whether the executor of a decedent who died in 2010 made a Section 1022 Election. For example, references to chapter 11 in §§ 2612(c)(1), 2642(b)(2)(A), 2642(f), 2651(e)(1)(B), and 2661(2) will be construed as if the decedent was subject to chapter 11 even if the decedent's executor made the Section 1022 Election.

III Transfer Certificates Under § 20.6325–1

Section 6324(a)(1) generally provides that, unless the estate tax is paid in full, a lien is imposed upon the gross estate of a decedent for 10 years from the date of death for any unpaid estate tax liability. Section 6324(a)(2) generally provides that, if the estate tax is not paid when due, then (1) any transferee, trustee, person in possession of property, or person who receives property from the gross estate as described in sections 2034 to 2042 shall be personally liable for the estate tax to the extent of the value of that property on the decedent's date of death and (2) any part of any property included in the gross estate that is transferred by such person shall be divested of the lien and a like lien shall attach to all of the property of such person. Section 6325(c) and the regulations thereunder provide procedures for issuing a certificate of discharge of lien for any property subject to any lien imposed by section 6324.

In the case of a transfer agent holding property registered in the name of a nonresident decedent who is not a citizen of the United States, § 20.6325–1(a) provides that the IRS may issue a transfer certificate to permit the transfer of property without liability for such decedent's estate tax. Specifically—

> [a] transfer certificate is a certificate permitting the transfer of property of a nonresident decedent without liability. . . . Corporations, transfer agents of domestic corporations, transfer agents of foreign corporations (except as to shares held in the name of a nonresident decedent not a citizen of the United States), banks, trust companies, or other custodians in actual or constructive possession of property, of such a decedent can insure avoidance of liability for taxes and penalties only by demanding and receiving transfer certificates before transfer of property of nonresident decedents.

Thus, transfer certificates requested with respect to property of a nonresident decedent who is not a citizen of the United States have been issued by the IRS when the Commissioner has been satisfied that the "tax imposed upon the estate, if any, has been fully discharged or provided for." Section 20.6325–1(c).

Concerns have been raised as to whether it is still necessary to obtain such transfer certificates prior to transferring property owned by nonresident decedents who are not citizens of the United States, who died in 2010, and whose executors make the Section 1022 Election. This notice clarifies that a transfer certificate is not required, and the IRS will not issue transfer certificates, with respect to the property of a nonresident decedent who is not a citizen of the United States, who died in 2010, and whose executor makes the Section 1022 Election.

IV Election to Treat a Trust as Part of an Estate Under Section 645

Under section 645, if the executor (if any) of an estate and the trustee of a qualified revocable trust so elect, the trust will be treated as part of the estate (and not as a separate trust) for income tax purposes for all taxable years of the estate ending after the date of the decedent's death and before the applicable date. Section 645(b)(2) defines "applicable date" as, "(A) if no return of tax imposed by chapter 11 is required to be filed, the date which is 2 years after

the date of the decedent's death, and (B) if such a return is required to be filed, the date which is 6 months after the date of the final determination of the liability for tax imposed by chapter 11." If an executor makes the Section 1022 Election, no return of tax imposed by chapter 11 is required to be filed. Accordingly, if an executor makes the Section 1022 Election, section 645(b)(2)(A) applies and the applicable date is the date that is 2 years after the date of the decedent's death.

REQUEST FOR COMMENTS

The Treasury Department and the IRS invite public comments on the guidance provided in this notice. All materials submitted will be available for public inspection and copying.

Comments may be submitted to Internal Revenue Service, CC:PA:LPD:PR (Notice 2011–66), Room 5203, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may also be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to the Couriers Desk at 1111 Constitution Avenue, NW, Washington, DC 20224, Attn:CC:PA:LPD:PR (Notice 2011–66), Room 5203. Submissions may also be sent electronically via the internet to the following email address: *Notice.comments@irscounsel.treas.gov*. Include the notice number (Notice 2011–66) in the subject line.

EFFECTIVE DATE

This notice is applicable to executors of the estates of decedents who died in 2010, and to persons acquiring property from such a decedent whose executor makes the Section 1022 Election. This notice is also applicable to donors who made a GST transfer or an indirect gift for purposes of the GST tax during 2010. The Treasury Department and the IRS intend to issue regulations to confirm the guidance set forth in this notice.

DRAFTING INFORMATION

The principal authors of this notice are Laura Urich Daly, Theresa Melchiorre, and Mayer Samuels of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice, contact Laura Urich Daly, Theresa Melchiorre, or Mayer Samuels at (202) 622–3090 (not a toll-free call).

PAPERWORK REDUCTION ACT

The collection of information contained in this notice has been submitted to the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) and OMB approval is pending. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The first, second, and third collection of information requirements, as required by section 6018(c) and (e), are in section I.C. of this notice. The collection of information relates to the requirement that the executor provide a statement to each recipient acquiring property reported on Form 8939. Section I.C of this notice also requires the executor to provide updated statements to each recipient of property affected by any adjustment made to Form 8939. Finally, section I.C of this notice requires the executor to provide any other information and supporting documentation as identified in the instructions to the Form 8939 or in any Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(*b*)). This collection of information is necessary for the proper performance of the function of the IRS in the collection of income tax when the property is later disposed of by the recipient or other holder of the property.

It is anticipated that the decedent's executor will complete and attach to Form 8939 schedules showing property received by each recipient acquiring property from a decedent. To meet this collection of information requirement, the executor is required to send a copy of the schedule relating to property received by that particular recipient to such recipient and to send an updated schedule to each recipient in the event the information on the schedule changes. The decedent's executor will also have to provide any other information and supporting documentation as identified in the instructions to the Form 8939 or in any Internal Revenue Bulletin. We estimate that approximately 7,000 estates of decedents who died in 2010 will file Form 8939 and that it will take an executor approximately 10 hours to comply with these requirements. The total reporting burden is estimated to be 70,000 hours.

The fourth collection of information requirement in this notice is in section II.A, as provided in Treasury Regulation § 26.2632–1(d)(1), and relates to allocating the decedent's unused GST exemption. This information collection is necessary for the proper performance of the function of the IRS in the collection of GST tax when there is a taxable termination or taxable distribution. We estimate that 6,000 executors of estates of decedents who died in 2010 will allocate the decedent's unused GST exemption on a Schedule R for Form 8939 attached to Form 8939 and that it will take each executor approximately 3 hours to prepare the documentation. The total reporting burden is estimated to be 18,000 hours.

Books or records relating to collections of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by section 6103.

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct liability
(Also Part 1 §§1022, 172, 165, 469, 1212, 1040, 684, 6018, 20.6325–1)

Rev. Proc. 2011–41

SECTION 1. PURPOSE

This revenue procedure provides optional safe harbor guidance under section 1022 of the Internal Revenue Code (Code), enacted by section 542 of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), P.L. 107–16 (115 Stat. 76–81). Section 1022 determines a recipient's basis in property acquired from the decedent (within the meaning of section 1022(e)) who died in 2010 if the decedent's executor elects to have section 1022 apply. Section 301(c) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, P.L. 111–312 (124 Stat. 3296) (TRUIRJCA), allows such an executor to elect to have the estate tax not apply and to have the carryover basis rules in section 1022 apply to

property transferred as a result of the decedent's death (Section 1022 Election). This revenue procedure does not address the time or manner in which such an executor makes the Section 1022 Election or allocates generation-skipping transfer (GST) exemption to transfers occurring as a result of such decedent's death. Instead, taxpayers must see Notice 2011–66 for such guidance.

SECTION 2. BACKGROUND

Subtitle A of title V of EGTRRA enacted section 2210, which made chapter 11 (the estate tax) inapplicable to the estate of any decedent who died in 2010 and chapter 13 (the GST tax) inapplicable to generation-skipping transfers made in 2010. On December 17, 2010, TRUIRJCA became law, and section 301(a) of TRUIRJCA retroactively reinstated the estate and GST taxes. However, section 301(c) of TRUIRJCA allows the executor of the estate of a decedent who died in 2010 to elect to apply the Code as though section 301(a) of TRUIRJCA did not apply with respect to chapter 11 and with respect to property acquired or passing from a decedent (within the meaning of section 1014(b)). Thus, section 301(c) of TRUIRJCA allows the executor of the estate of a decedent who died in 2010 to elect not to have the provisions of chapter 11 apply to the decedent's estate, but rather, to have the provisions of section 1022 apply.

SECTION 3. SCOPE

The safe harbor procedures of this revenue procedure apply to executors of the estates of decedents who died in 2010 and to recipients of property acquired from such decedents, if the executors make the Section 1022 Election. If the executor of the estate of the decedent who died in 2010 makes the Section 1022 Election and follows the applicable provisions of section 4 of this revenue procedure and takes no return position contrary to any provisions of section 4, the Internal Revenue Service (IRS) will not challenge the taxpayer's ability to rely on the provisions of section 4 either on the Form 8939, *Allocation of Increase in Basis for Property Acquired From a Decedent*, or any other return of tax.

SECTION 4. APPLICATION

.01 *Application of Section 1022*.

(1) *In General*. Section 1022 applies to the estate of a decedent who died in 2010 only if the executor, as defined in section 2203, makes the Section 1022 Election as described in Notice 2011–66. Section 1022(a)(1) generally provides that property acquired from the decedent (within the meaning of section 1022(e)) (hereinafter, *acquired from the decedent*) is treated as having been transferred by gift. If the decedent's adjusted basis is less than or equal to the property's fair market value (FMV) determined as of the decedent's date of death, the recipient's basis is the adjusted basis of the decedent. Section 1022(a)(2)(A). If the decedent's adjusted basis is greater than that FMV, the recipient's basis is limited to that FMV. Section 1022(a)(2)(B).

If the executor of the estate of a decedent who died in 2010 makes the Section 1022 Election, section 1022 applies to determine a recipient's basis in all property acquired from that decedent, regardless of the year in which the property is sold or distributed. Accordingly, if property is acquired from the decedent who died in 2010 and the executor makes the Section 1022 Election, then when the property is sold during 2010, 2011 or any subsequent year, the recipient's (seller's) basis in the property is determined under section 1022 rather than under section 1014.

Furthermore, sections 1022(b) and (c) allow the executor of such a decedent's estate to allocate additional basis (Basis Increase) to increase the basis of certain assets that both are acquired from the decedent and are owned by the decedent (within the meaning of section 1022(d)) (hereinafter, *owned by the decedent*) at death. If the property is acquired from and owned by the decedent, and if the decedent's adjusted basis in the property is less than the property's FMV on the decedent's date of death, then the executor generally may allocate Basis Increase to the property, provided that the property's total basis may not exceed the property's FMV on the date of death.

(2) *Property Not Subject to Section 1022*. If the decedent's executor makes the Section 1022 Election, section 1022 will apply to determine a recipient's basis only in property acquired from the decedent as further described in section 4.01(3) of this revenue procedure. Thus, section 1022 does not determine the recipient's basis in every type of property transferred from a decedent who died in 2010. An example of property that is not property acquired from the decedent is property that constitutes a right to receive an item of income in respect of a decedent under section 691 (IRD). Section 1022(f). For purposes of section 1022, annuities subject to income tax under section 72 are considered property that constitutes the right to receive an item of IRD. Rev. Rul. 2005–30, 2005–1 C.B. 1015. The recipient's basis in property that is not subject to section 1022 is determined under other applicable sections of the Code.

(3) *Property Acquired From the Decedent — Section 1022(e)*. Property acquired from the decedent (within the meaning of section 1022(e)) is property acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent. The term also includes property transferred by the decedent during the decedent's lifetime: (i) to a qualified revocable trust as defined in section 645(b)(1), regardless of whether the election under section 645 is made for that trust; or (ii) to any other trust with respect to which the decedent reserved the right to make any change in the enjoyment thereof through the exercise of a power to alter, amend, or terminate the trust (which, for this purpose, is deemed to include a retained reversionary interest in the trust on death and trust property subject to any retained power of appointment). Finally, the term includes any other property that passes from the decedent by reason of death to the extent that such property passes without consideration, such as: (i) any property transferred at the decedent's death by reason of the decedent's holding and/or exercising a general power of appointment (as defined in section 2041) with respect to such property if that power was not created by the decedent, (ii) property held by the decedent and another person as joint tenants with right of survivorship or as tenants by the entirety; and (iii) the surviving spouse's one-half interest in community property (as discussed in section 4.05 of this revenue procedure).

The term does not include, however, a decedent's interest in a qualified terminable interest property (QTIP) trust or similar arrangement described in section

1022(c)(5) funded for the benefit of the decedent by the decedent's predeceased spouse. As a result, this property is not subject to section 1022 and a recipient's basis in this property will not be determined under section 1022. See section 4.01(2) of this revenue procedure.

(4) *Property Owned by the Decedent — Section 1022(d).* Property acquired from the decedent must also be owned by the decedent at death (within the meaning of section 1022(d)) to be eligible for the allocation of Basis Increase under sections 1022(b) and/or (c). Section 1022(d)(1)(A). Thus, property may be acquired from the decedent, and its basis will be determined under section 1022(a), but will not be eligible to receive an allocation of Basis Increase unless that property is also owned by the decedent at death. Property owned by the decedent at death includes, but is not limited to: (i) any property legally titled in the name of the decedent at death (and not held by the decedent solely in a legal or representative capacity); (ii) certain jointly owned property, whether owned as tenants in common or with rights of survivorship (see section 1022(d)(1)(B)(i)); (iii) property transferred by the decedent during life to a qualified revocable trust as defined in section 645(b)(1), regardless of whether the election under section 645 is made for that trust; and (iv) certain community property (see section 1022(d)(1)(B)(iv)).

Section 1022(d)(1)(B) provides additional rules defining ownership for this purpose and specifically states that, for purposes of determining whether Basis Increase may be allocated to property, certain property is not owned by the decedent at death. For example, property over which the decedent holds any power of appointment is not considered owned by the decedent at death. In addition, although considered to have been acquired from the decedent, property transferred to a trust by the decedent during life in which the decedent retained a power to alter, amend, or terminate the trust is not considered owned by the decedent at death for this purpose. Property transferred to a trust by the decedent during life in which the decedent retained an income interest is not considered owned by the decedent at death solely by reason of that retained income interest. In addition, because of the different definitions of ownership in sections 679 and 1022, although a transfer of property to a foreign trust by a United States grantor, for example, may be sufficient to cause that grantor to be treated as the owner of at least a portion of that trust for income tax purposes under section 679, such a transfer is not sufficient to result in the trust's being considered to be owned by the United States grantor at that grantor's death for purposes of section 1022(d).

Notwithstanding these examples, however, even though the property in these types of trusts would not be deemed to be owned by the decedent, if the terms of the trust require the trust property to revert back to the decedent upon death, then such property is deemed to be owned by the decedent. Finally, an interest in a QTIP trust or similar arrangement described in section 1022(c)(5) funded for the benefit of the decedent by a predeceased spouse of the decedent is not owned by the decedent for this purpose.

The provisions of sections 4.01(2), (3), and (4) are illustrated by the following examples:

Example 1. On August 1, 2006, decedent (D) created a qualified personal residence trust (QPRT) pursuant to § 25.2702–5(c). The term of the QPRT expires on July 31, 2011. The QPRT instrument provided that, if D dies prior to July 31, 2011, the property in the QPRT is to be distributed to D's child (C). D died in 2010, and D's executor made the Section 1022 Election. In this case, the property in the trust had been transferred to the trust by D during D's lifetime. The QPRT is not a qualified revocable trust as defined in section 645(b)(1) nor is it a trust over which the decedent reserved the right to make any change in the enjoyment thereof through the exercise of a power to alter, amend, or terminate the trust. The property that passes to C under the QPRT instrument by reason of D's death is not considered to have been acquired from D and thus, section 1022 is not applicable to determine C's basis in the property held in the QPRT. Instead, C's basis in this property is determined under other applicable sections of the Code.

Example 2. Assume the same facts as in *Example 1*, except that the QPRT instrument provided that, if D dies prior to July 31, 2011, the QPRT terminates and the property in the QPRT is to be distributed to D's estate. Because the trust property becomes the property of D's estate at D's death, the trust property is considered to have been acquired from D. Section 1022(e)(1). For the same reason, the property is also considered owned by D and, therefore, Basis Increase may be allocated to this trust property.

(5) *Property Owned By and Acquired From the Decedent But Not Eligible for the Allocation of Basis Increase.* Notwithstanding the rules regarding the definition of property owned by and acquired from the decedent, section 1022 provides that Basis Increase may not be allocated to two types of property. First, pursuant to section 1022(d)(1)(C), the executor may not allocate Basis Increase to property that is acquired by the decedent by gift or by *inter vivos* transfer for less than adequate and full consideration in money or money's worth during the three-year period ending on the date of the decedent's death. This prohibition does not apply, however, to property acquired by the decedent from the decedent's spouse, provided the property had not been transferred to the spouse during such three-year period in whole or in part by gift or by *inter vivos* transfer for less than adequate and full consideration in money or money's worth.

Second, pursuant to section 1022(d)(1)(D), the executor may not allocate Basis Increase to the stock or securities of a foreign personal holding company, a DISC or former DISC, a foreign investment company, or a passive foreign investment company, unless such company is a qualified electing fund as defined in section 1295 with respect to the decedent.

.02 *Amount of Basis Increase.*

(1) *Basis Increase.* Basis Increase consists of the sum of the General Basis Increase (Aggregate Basis Increase and Carryovers/Unrealized Losses Increase) under section 1022(b) and the Spousal Property Basis Increase under section 1022(c).

(2) *General Basis Increase.* The General Basis Increase is the sum of the Aggregate Basis Increase and the Carryovers/Unrealized Losses Increase under section 1022(b).

(a) *Aggregate Basis Increase.* The Aggregate Basis Increase is $1,300,000 under section 1022(b)(2)(B).

(b) *Carryovers/Unrealized Losses Increase.* The Carryovers/Unrealized Losses Increase consists of the sum of: (i) the amount of any capital loss carryovers under section 1212(b) that would (but for the decedent's death) have been carried from the decedent's last taxable year to a later taxable year; (ii) the amount of any net operating loss carryovers under section 172 that would (but for the decedent's death) have been carried from the decedent's last taxable year to a later taxable year; and (iii) the amount of unrealized losses that would have been allowable under section 165 if the property acquired from the decedent had been sold at FMV immediately before the decedent's death. Section 1022(b)(2)(C).

The capital loss carryovers under section 1212(b) and the net operating loss carryovers under section 172 available to be included in General Basis Increase are the losses that would carry forward to years after the year of the decedent's death.

The amount of unrealized losses consists solely of the losses described in section 165(c)(1) and (2) from all property acquired from the decedent that would have been allowable as a deduction, if the property had been sold at FMV immediately before the decedent's death. However, losses described in section 165(c)(3) are sustained prior to the decedent's death and would not arise on a hypothetical sale of the property. These losses therefore must be claimed instead on the decedent's final Form 1040, and may not be included in the Carryovers/Unrealized Losses Increase. For the purpose of computing unrealized losses, the capital loss limitations referred to in section 165(f) are ignored. Thus, for example, the amount of any loss that would have been allowable under section 165 if the property acquired from the decedent had been sold at FMV immediately before the decedent's death is determined without the dollar limitations on capital losses under section 1211. Section 1022(b)(2)(C)(ii).

Existing income tax rules will apply to determine the decedent's share of these loss carryovers and unrealized losses under section 172 and section 1212(b) if the decedent's final Form 1040 is filed jointly with the decedent's surviving spouse. Thus for example, if a calendar year decedent and the surviving spouse file a joint Form 1040 for 2010, these amounts will be determined based on their tax liability with respect to the decedent's final taxable year ending on the date of the decedent's death and the surviving spouse's taxable year ending on December 31, 2010. With regard to such loss carryovers and unrealized losses arising from community property, see sections 4.05 and 4.06(4) of this revenue procedure.

The provisions of this section 4.02(2)(b) are illustrated by the following example:

Example 3. D owned 100 shares of stock that D held for profit within the meaning of section 165(c)(2). The stock is a capital asset, and any gain or loss from the sale of the stock would be long-term capital gain or loss under sections 1221 and 1222(3). D died in 2010, still owning the stock. As of D's date of death, D's adjusted basis in the stock pursuant to section 1011 was $5,000, and the stock's FMV on D's date of death was $1,000. D did not sell the stock during life, and thus did not incur a loss under section 165(c)(2) reportable on D's final Form 1040. The stock is considered to be property owned by and acquired from D. D's executor made the Section 1022 Election. If D had sold the stock immediately prior to D's death, D would have had a net long-term capital loss of $4,000. Based on D's 2010 taxable income, D would have been able to deduct $3,000 of the loss and $1,000 would have been carried over to future years. Section 1211(b). For purposes of section 1022, however, the full unrealized net long-term capital loss of $4,000, that would have been available to D if D had sold the stock before death, is available as a Carryovers/Unrealized Losses Basis Increase.

(3) *Spousal Property Basis Increase*. The Spousal Property Basis Increase is $3,000,000 under section 1022(c)(2) and may be allocated to any or all property owned by and acquired from the decedent that also satisfies the definition of qualified spousal property in section 1022(c)(3). Qualified spousal property is property that either is transferred outright to the decedent's surviving spouse (within the meaning of section 1022(c)(4)) or is QTIP (within the meaning of section 1022(c)(5)), whether or not held in trust. The definition of QTIP under this provision does not require that a QTIP election under section 2056(b)(7) be made.

The executor may allocate Spousal Property Basis Increase to qualified spousal property that has already been distributed. See paragraph I.D.2 of Notice 2011–66 regarding relief for allocating Spousal Property Basis Increase to such property distributed after the due date of the Form 8939.

In addition, Spousal Property Basis Increase also may be allocated to property that is sold (regardless of whether the allocation of Spousal Property Basis Increase is made before or after such sale) prior to its distribution. However, this allocation may be made only to the extent that the executor (1) certifies on the Form 8939 that the net proceeds from the sale of that property will be distributed to or for the benefit of the decedent's surviving spouse in a manner that would qualify property as qualified spousal property, and (2) attaches to Form 8939 each document providing a bequest or devise to the surviving spouse.

The allocation of Spousal Property Basis Increase to property not distributed in kind is illustrated by the following examples. In each example, assume that the decedent's Aggregate Basis Increase and Carryovers/Unrealized Losses Increase have been fully allocated to other assets.

Example 4. D died in 2010 owning 20,000 shares of Corporation X stock. D's executor made the Section 1022 Election. D's adjusted basis in the stock is $600,000 ($30 per share), and the FMV on D's date of death is $2,000,000 ($100 per share). Under the terms of D's will, D's Spouse (S) is to receive 50 percent of D's estate, outright. Four months after D's death, the FMV of the stock declines to $1,800,000 ($90 per share). D's executor sells all 20,000 shares of the stock and receives $1,770,000 in proceeds net of sales commissions (thus, $88.50 per share). D's executor intends to distribute all of the proceeds from the sale of the stock to S, in partial satisfaction of S's residuary bequest; there are no known outstanding liabilities that would reduce this distribution. D's executor may allocate up to $1,400,000 of Spousal Property Basis Increase ($70 to each of the 20,000 shares of stock) if the required certification and supporting documentation is included on a timely filed Form 8939. (Note that, to the extent that more than $58.50 per share is allocated to the stock, the sale will generate a loss.)

Example 5. The facts are the same as in *Example 4* except that D's executor applies $165,000 of the net proceeds from the sale of the stock to pay administrative expenses of D's estate. D's executor intends to distribute the remaining $1,605,000 of net proceeds from the sale of the stock to S. Spousal Property Basis Increase may be allocated to no more than 18,135 shares. This number of shares is determined either by dividing the net proceeds to be distributed to S by the net per-share proceeds ($1,605,000 / $88.50 = 18,135.6 shares, limited for this purpose to 18,135 whole shares), or by calculating the ratio of the net proceeds payable to S to the total net proceeds (20,000 shares x $1,605,000 / $1,770,000 = 18,135.6 shares, thus limited to 18,135 whole shares). As in *Example 4*, D's executor may allocate up to $70 of Spousal Property Basis Increase to each of these 18,135 shares of the stock (for a total of $1,269,450), all of the net proceeds of which will be distributed to S, provided a certification and supporting documentation are included on a timely filed Form 8939.

Example 6. D died in 2010 owning personal property with an adjusted basis of $200,000 and a FMV on D's date of death of $500,000. D's executor made the Section 1022 Election. Under the terms of D's will, D's spouse (S) is to receive 50 percent of D's estate, outright. Four months after D's death, D's executor sells the personal property for $600,000. D's executor applies $150,000 of the net proceeds from the sale of the personal property to pay administrative expenses of D's estate and intends to distribute the remaining $450,000 of net proceeds from the sale of the personal property to S. D's executor may allocate no more than $225,000 of Spousal Property Basis Increase to the personal property. This maximum allocation is determined by multiplying the unrealized appreciation at death ($300,000) by the ratio of net proceeds to be distributed to S over the total net proceeds of the sale. Thus, D's executor may allocate up to $225,000 ($300,000 X ($450,000 / $600,000)) of Spousal Property Basis Increase to the personal property, provided a certification and supporting documentation are included on a timely filed Form 8939.

Spousal Property Basis Increase also may be allocated to property held by a testamentary charitable remainder trust (CRT) as defined in section 664 (subject to the limit of section 1022(d)(2)), if the surviving spouse is the sole non-charitable beneficiary of the CRT and the CRT would have qualified for the marital deduction under section 2056(b)(8) if the executor of the decedent's estate had not made the Section 1022 Election.

(4) *Nonresident Decedents who are not citizens of the United States*. In the case of a nonresident decedent who was not a citizen of the United States at death, the amount of the Aggregate Basis Increase is limited to $60,000 and is not increased by any Carryovers/Unrealized Losses Increase. This limitation in section 1022(b)(3), however, only applies to limit the available General Basis Increase to $60,000. Accordingly, an executor of the estate of a nonresident decedent who was not a citizen of the United States at death may allocate Spousal Property Basis Increase to qualified spousal property (within the meaning of section 1022(c)(3)) owned by and acquired from the decedent.

.03 *General Rules for Allocating Basis Increase*. The executor may allocate Basis Increase to property owned by and acquired from the decedent on a property-by-property basis, provided that the decedent's adjusted basis in each such property (after the allocation, if any) does not exceed the FMV of that property at the decedent's death. For example, Basis Increase may be allocated to one or more shares of stock or to a particular block of stock rather than to the decedent's entire holding of that stock. Generally, Basis Increase may be allocated to property owned by and acquired from the decedent even after the executor has disposed of or distributed the property. For a special rule regarding Spousal Property Basis Increase, see section 4.02(3) of this revenue procedure.

For each property, the sum of the decedent's adjusted basis in that property and the Basis Increase allocated to that property may not exceed the FMV of that property on the decedent's date of death. Section 1022(d)(2). Under this rule, the executor may not allocate any Basis Increase to increases in value occurring after the decedent's death.

For purposes of section 1022(a), references to the term "property" include interests in that property. Thus, Basis Increase may be allocated to some or all of the decedent's shares of stock in a particular company, or to a life or remainder interest owned by the decedent at death. However, if, by reason of the decedent's death, the decedent's property is divided into different interests that are not undivided portions or fractional interests of each and every interest or right in the property that was owned by the decedent, Basis Increase may not be allocated separately to the various interests in that property created by reason of the decedent's death. An example of such a division of property is the division of property owned outright by the decedent at death into a life interest and a remainder interest in that property. Basis Increase may be allocated to the property owned by the decedent at death, but may not be allocated separately to the life estate and/or remainder interest.

.04 *Determination of Fair Market Value*.

(1) *In General*. The FMV of property acquired from the decedent who died in 2010 is determined in the same manner for purposes of section 1022 as for purposes of the estate tax. Thus, the provisions contained in the regulations under section 2031 that require appraisals to determine the FMV of certain property included in the gross estate for federal estate tax purposes also apply for purposes of determining the FMV of property acquired from the decedent under section 1022. The executor must attach any appraisals required under section 2031 to the Form 8939.

(2) *Aggregation Rule*. The Basis Increase allocated to property acquired from the decedent by a recipient cannot increase the recipient's basis in that property or property interest above the FMV of that property or interest in the hands of the decedent at death. See section 1022(d)(2). Therefore, for purposes of section 1022, the FMV of an undivided portion of the decedent's property that is acquired from the decedent at death is a fractional share of the FMV of the decedent's property at death. Thus, if each of two or more recipients acquires an undivided portion of a property from the decedent, then the FMV of each recipient's portion of that property for purposes of section 1022 is the FMV of the decedent's entire interest in the property at death multiplied by a fraction. The numerator of that fraction is the undivided portion of the decedent's property acquired by that recipient, and the denominator is the decedent's entire interest in that property at death. An undivided portion of the decedent's property refers to a fraction or percentage of each and every interest or right the decedent held in the property at death.

.05 *Special Rules for Community Property*. The decedent's interest in community property held by the decedent and the surviving spouse under the community property laws of any state or possession of the United States or any foreign jurisdiction is treated as owned by and acquired from the decedent if the decedent's interest satisfies the requirements of sections 1022(d) and (e). If at least one-half of the whole of the community interest is treated as owned by and acquired from the decedent under these provisions (without regard to the special rule for community property in section 1022(d)(1)(B)(iv)), the surviving spouse's one-half interest in that community property also is treated as owned by and acquired from the decedent for purposes of section 1022. Section 1022(d)(1)(B)(iv). Accordingly, the surviving spouse's basis in his or her one-half interest in community property, as determined under section 1022(a), will be the lesser of the surviving spouse's adjusted basis of that interest in such community property or the FMV of that interest on the decedent's date of death. In addition, Basis Increase may be allocated to the surviving spouse's one-half interest in such community property.

If both spouses' interests in such community property are treated as owned by and acquired from the decedent as described in the preceding paragraph, all of the unrealized losses described in section 4.02(2)(b) of this revenue procedure that would have been allowable to both the decedent and the surviving spouse if the property had been sold at FMV immediately before the decedent's death are included in the General Basis Increase. In contrast, only the decedent's net operating loss carryovers and capital loss carryovers are eligible to be included in the General Basis Increase. Further, to the extent the decedent's net operating loss carryovers and capital loss carryovers are deductible on the final jointly filed Form 1040, they are not available to be added to the General Basis Increase.

The provisions of this section 4.05 are illustrated by the following examples:

Example 7. (i) D and D's spouse (S) live in a community property state (State). D died in 2010, and D's executor made the Section 1022 Election. At D's death, Property X, community property of D and S under the laws of State, had an adjusted basis of $1,000,000 and a FMV of $8,000,000. D and S used Property X in a trade or business within the meaning of section 165(c)(1). Under the community property laws of State, each spouse is entitled to an undivided equal share of community property. D and S have filed joint Forms 1040 for all taxable years in which they have owned Property X, including 2010, the year of D's death. D and S have a total of $100,000 of net operating losses under section 172, after the deductions taken on D's and S's final joint Form 1040. $50,000 of the $100,000 of net operating losses would (but for D's death) be carried from D's last taxable year to a later taxable year of D. Under the community property laws of State, upon the death of a married person, one-half of the community property belongs to the decedent and the other one-half belongs to the surviving spouse. Therefore, one-half of Property X belongs to D and the other one-half belongs to S. In D's will, D bequeathed D's one-half interest in Property X to D's child (C). In this case, C acquired Property X by bequest, and therefore, Property X is acquired from D and is subject to the provisions of section 1022. As a result, C's basis in Property X under section 1022(a)(2) is $500,000, the lesser of D's adjusted basis in D's one-half interest in Property X or the FMV of that interest at D's death. In addition, because Property X is considered as owned by D at the time of death, General Basis Increase may be allocated to D's interest in Property X. The executor of D's estate has $1,300,000 in Aggregate Basis Increase and $50,000 (D's share of the $100,000 of the unused net operating losses) in Carryovers/Unrealized Losses Increase available to allocate to the interest acquired by C in Property X.

(ii) On the date of D's death, the other one-half interest in Property X belongs to S under the laws of State. As a result, for purposes of section 1022, S's one-half interest in Property X is deemed to have been owned by and acquired from D. Under section 1022(a)(2), S's basis in S's one-half interest in Property X is $500,000, the lesser of S's adjusted basis in S's one-half interest or the FMV of that interest as of D's death. That interest has a FMV on D's death of $4,000,000.

(iii) The executor may allocate Basis Increase to S's one-half interest in Property X. In this case, the executor decides to allocate $450,000 of Aggregate Basis Increase, $50,000 of Carryovers/Unrealized Losses Increase, and $3,000,000 in Spousal Property Basis Increase to S's one-half interest in Property X. As a result, S's basis in S's one-half interest in Property X is $4,000,000 (the sum of S's own adjusted basis of $500,000 and S's allocated Basis Increase of the sum of $450,000, $50,000, and $3,000,000), equal to its FMV as of D's date of death. D's $50,000 in unused net operating losses is included in Basis Increase that is allocated by D's executor to S's interest in Property X; the other $50,000 of the unused net operating losses is available to S on S's subsequent income tax returns.

(iv) With respect to the one-half interest in Property X passing from D to C, the executor may allocate any or all of the remaining General Basis Increase of $850,000 to this property. In this case, the executor allocates the entire remaining $850,000 of General Basis Increase to C's one-half interest in Property X. C's basis in the one-half interest in Property X is $1,350,000 ($500,000 plus $850,000).

Example 8. (i) The facts are the same as in *Example 7*, except that the FMV of Property X on D's date of death was $800,000. Under section 1022(a)(2), S's basis in S's one-half interest in Property X is $400,000, the lesser of S's $500,000 in adjusted basis and the FMV of that interest in Property X as of D's date of death. D's executor may not allocate any Aggregate Basis Increase, Carryovers/Unrealized Losses Increase, or Spousal Property Basis Increase to spouse's one-half interest in the community property because the property's basis, as augmented under section 1022, may not exceed its FMV on D's date of death. For the same reason, D's executor may not allocate any General Basis Increase to the one-half interest in Property X passing to C.

(ii) A loss of $200,000 would have been incurred if Property X had been sold at FMV immediately before D's death. All of this $200,000 is available as Carryovers/Unrealized Losses Increase that may be allocated to property owned by and acquired from D with a basis pursuant to section 1022(a)(2) that is less than the FMV as of D's date of death.

.06 *Interaction of Section 1022 with Certain Other Income Tax Provisions.*

(1) *Holding Period of Inherited Property.* To the extent the recipient's basis in property acquired from the decedent is determined under section 1022, the recipient's holding period of that property shall include the period during which the decedent held the property, whether or not the executor allocates any Basis Increase to that property.

In computing the applicable percentage under section 1250 for purposes of determining the amount of ordinary gain on the sale of section 1250 property, section 1250(e) applies to determine the period of time the recipient is deemed to have held section 1250 property acquired by gift or on the death of a decedent. Therefore, to the extent a recipient's basis in property is determined under section 1022, the recipient's holding period of such property under section 1250(e)(2) includes the period during which the property was held by the decedent, regardless of whether the executor allocates any Basis Increase to that property.

(2) *Tax Character of Inherited Property.* The tax character of property acquired from the decedent by a recipient is determined in the same way as the holding period. Thus, to the extent a recipient's basis in property is determined under section 1022, the tax character of the property is the same as it would have been in the hands of the decedent. Consequently, for property described in section 1221 (capital assets) or section 1231 (property used in a trade or business and involuntary conversions), and for property subject to section 1245 (depreciation recapture upon disposition of certain depreciable property) or section 1250 (depreciation recapture upon disposition of certain depreciable real property), the tax character of the property described in these sections (the basis of which is determined under section 1022) in the hands of the recipient is the same as it would have been in the hands of the decedent. However, the tax character of the property may be affected by a subsequent change in the recipient's use of the property.

The provisions of this section 4.06(2) are illustrated by the following example:

Example 9. D owned tangible personal property (section 1245 property) and claimed on D's income tax return a depreciation deduction under section 168 that would have been subject to recapture under section 1245 if D had sold the property prior to D's death. D died in 2010 and D's executor made the Section 1022 Election. D bequeathed all of D's tangible personal property to D's child (C). Because C's basis is determined under section 1022, the property is section 1245 property in the hands of C and therefore will be subject to recapture under section 1245 when sold by C, regardless of whether the property is depreciable property in the hands of C or whether the executor allocates any Basis Increase to that property. *See* § 1.1245–3(a)(3).

(3) *Depreciation of Property Acquired from the Decedent.* If section 1022 applies to property acquired from the decedent that is depreciable property in the hands of the recipient, regardless of whether the executor allocates any Basis Increase to the property, the recipient is treated for depreciation purposes as the decedent for the portion of the recipient's basis in the property that equals the decedent's adjusted basis in that property. Consequently, the recipient determines any allowable depreciation deductions for this carryover basis by using the decedent's depreciation method, recovery period, and convention applicable to the property. If the property is depreciable property in the hands of both the decedent and the recipient during 2010, the allowable depreciation deduction for 2010 for the decedent's adjusted basis in the property is computed by using the decedent's depreciation method, recovery period, and convention applicable to the property, and is allocated

between the decedent and the recipient on a monthly basis. This allocation is made in accordance with the rules in § 1.168(d)–1(b)(7)(ii) of the Income Tax Regulations for allocating the depreciation deduction between the transferor and the transferee.

The portion of the recipient's basis in the property that exceeds the decedent's adjusted basis in the property as of the decedent's date of death (for example, the Basis Increase allocated to the property by the executor) is treated for depreciation purposes as applying to a separate asset that the recipient placed in service on the day after the date of the decedent's death. Accordingly, the recipient determines any allowable depreciation deductions for this excess basis by using the depreciation method, recovery period, and convention applicable to the property on its placed-in-service date or, if not held on that date as depreciable property by the recipient, on the date of the property's conversion to depreciable property.

(4) *Passive Activity Loss Provisions*. Section 469(a) disallows certain losses from passive activities. However, pursuant to section 469(b), losses disallowed under section 469(a) may be suspended and carried forward. Section 469(g)(2) provides that, if an interest in a passive activity is transferred by reason of the taxpayer's death, the taxpayer may treat suspended passive losses as losses that are not from a passive activity (and therefore may deduct the losses) to the extent such losses are greater than the excess (if any) of the basis of such property in the hands of the transferee, over the adjusted basis of such property immediately before the death of the taxpayer. Section 469(j)(6) provides that, when an interest in a passive activity is transferred by gift, the basis of such interest immediately before the transfer is increased by the amount of any passive activity losses allocable to such interest that have not been allowed as deductions as a result of section 469(a). Once used to increase the donor's basis, these losses may not be deducted for any taxable year.

Because property owned by the decedent at death will be treated under section 1022 as having been transferred by gift, section 469(j)(6), rather than section 469(g)(2), applies to determine the decedent's adjusted basis in such property. The basis adjustment under section 469(j)(6) is deemed to occur immediately prior to the decedent's death, and thus is applied to determine the decedent's adjusted basis in the property at death as described in section 1022(a)(2)(A). In addition, any loss that would have been sustained under sections 165(c)(1) or (c)(2) on a hypothetical sale of the property immediately prior to the decedent's death (equal to the excess of the decedent's adjusted basis (determined as described under section 469(j)(6)) over the FMV at death) may be included in the section 165 losses in the General Basis Increase. Because the reduction in the hypothetical loss under section 165 by reason of the section 469 basis adjustment equals the amount of section 469 loss added to the decedent's basis, there is no duplication of a benefit under these two sections.

Section 1022(d)(1)(B)(iv) provides that the surviving spouse's interest (as well as the decedent's interest) in certain community property is deemed to have been owned by and acquired from the decedent, and thus 100 percent of that community property is deemed to have been transferred by gift for purposes of section 1022. Because section 469(j)(6) increases basis by the amount of suspended passive activity losses allocable to the interest that is transferred by gift, 100 percent of those losses, rather than only the decedent's one-half of such losses, are to be added to determine the decedent's and the spouse's adjusted basis in that community property for purposes of section 1022(a) and to determine the amount of unrealized section 165 losses to be included in the General Basis Increase. To the extent that losses attributable to the spouse's interest in the community property are used to increase basis and/or were included in Carryovers/Unrealized Losses Increase allocated by the decedent's executor, such losses may not thereafter be deducted by the spouse. However, to the extent that losses attributable to the spouse's interest in community property are not so used by the decedent's executor, they remain the spouse's suspended passive activity losses. For purposes of this computation, these losses will be deemed to be the last part of Basis Increase allocated, and the decedent's share of these losses will be deemed to be allocated before the surviving spouse's share of these losses.

The provisions of this section 4.06(4) are illustrated by the following examples:

Example 10. D owned an apartment building that generated losses that have been disallowed under section 469. D died in 2010 and D's executor made the Section 1022 Election. The building is property owned by and acquired from D. Pursuant to D's will, D's child (C) is to acquire the building. On D's date of death, the FMV of the building was $100,000, the basis of the building was $10,000, and the suspended passive activity losses allocable to the building were $50,000. Pursuant to section 469(j)(6), the $50,000 in suspended passive activity losses are added to D's basis of $10,000, resulting in an adjusted basis of $60,000. For purposes of section 1022(b)(2)(C)(ii), a hypothetical sale of the property just before D's death would have produced a gain of $40,000 ($100,000 FMV less D's adjusted basis of $60,000), so there is no loss under section 165 from this property. C's basis in the building as of D's date of death is $60,000, plus any amount of the General Basis Increase allocated to this property.

Example 11. Assume the same facts as in *Example 10*, except that the suspended passive activity losses allocable to the building are $200,000 instead of $50,000. Pursuant to section 469(j)(6), the $200,000 in suspended passive activity losses are added to D's basis of $10,000 resulting in an adjusted basis of $210,000. Under section 1022(a)(2), C's basis in the building is $100,000 (the lesser of D's adjusted basis in the building ($210,000) and the building's FMV on the date of death ($100,000)). Thus, C's basis in the building reflects $90,000 of the section 469 suspended losses. If the property had been sold at FMV immediately before D's death, a section 165 loss of $110,000 would have been allowable (FMV of $100,000 minus $210,000 of D's adjusted basis). This $110,000 constitutes the section 165 loss that may be included in the General Basis Increase.

(5) *Recognition of Gain on Satisfaction of Pecuniary Bequest with Appreciated Property*. Section 1040, as applicable to the estates of decedents who died in 2010 and whose executors make the Section 1022 Election, provides that, if an executor distributes appreciated property to satisfy a pecuniary bequest, the estate must recognize gain to the extent the FMV of the distributed property on the date of distribution exceeds its FMV on the date of the decedent's death. The basis of that property in the hands of the recipient then equals the sum of the basis of that property immediately before the distribution and the amount of gain recognized by the estate.

Section 1040 further provides that the same rule will apply to distributions of appreciated trust property made in satisfaction of trust provisions that are the equivalent of a pecuniary bequest, but only to the extent so provided in regulations. This safe harbor will apply this rule to quali-

fied revocable trusts as defined in section 645(b)(1), as well as to trusts that would have been included in the decedent's gross estate for federal estate tax purposes under section 2036, 2037, or 2038 had the decedent's executor not made the Section 1022 Election.

The provisions of section 1040, however, do not apply to the distribution of property that constitutes the right to receive an item of IRD in satisfaction of a pecuniary bequest.

(6) *Sale or Exchange Treatment of Transfers to Nonresident Aliens.* Section 684, enacted in 1997, generally provides that any transfer of property by a United States person to a foreign estate or trust (except to the extent that a person is treated as the owner of the trust under section 671) is treated as a sale or exchange of such property, and requires the transferor to recognize gain in the amount of any excess of the FMV of the property at the time of the transfer over the transferor's adjusted basis in the property. For transfers of property occurring on the death of a decedent whose executor makes the Section 1022 Election, this provision also applies to transfers of property by United States persons to nonresident aliens.

The existing regulations provide an exception to the general rule of taxation under section 684 in the case of a transfer of property by reason of the death of a United States transferor, but only if the basis of such property in the hands of the recipient is determined under section 1014(a). Section 1.684–3(c). If the recipient's basis in such property is not determined under section 1014(a), section 684 continues to apply, and the United States transferor is treated as having transferred the property immediately before death and is required to recognize the built in gain in the property transferred at that time. Section 1.684–3(g), *Example 3*.

For purposes of applying section 684 to transfers of property by reason of the death of a United States person in 2010 whose executor makes the Section 1022 Election, the question has arisen as to whether (1) section 684 applies prior to section 1022, with the effect of treating the transfer as a sale for FMV before any Basis Increase may be allocated to the property, or (2) whether the executor's allocation of Basis Increase is deemed to increase the recipient's basis in the property before the amount of any unrecognized gain taxable under section 684 is determined.

If the property is owned by and acquired from the decedent, the executor's allocation of Basis Increase will be deemed to occur prior to the application of section 684. Specifically, in determining the adjusted basis of the property in the hands of the decedent under section 684(a)(2), any allocation of Basis Increase shall be deemed to occur prior to the computation of gain under section 684. Thus, the amount of gain recognized under section 684 on the transfer may be reduced or even eliminated if sufficient Basis Increase is allocated to such property.

However, if the property transferred is not owned by the decedent at death, then no Basis Increase may be allocated to the property, and the decedent will be required to recognize all of the unrealized gain in the property transferred to the foreign estate or trust or to the nonresident alien as provided in section 684.

The provisions of this section 4.06(6) are illustrated by the following examples:

Example 12. D, a United States citizen, acquired stock in 1984 for $1,000 that had a FMV of $30,000 on D's date of death in 2010. D bequeathed the stock to D's brother (N), a nonresident alien. The executor of D's estate made the Section 1022 Election, and, therefore, may allocate General Basis Increase of up to $29,000 to this stock. Such an allocation of basis will be deemed to have occurred prior to the deemed sale under section 684. Accordingly, if the executor allocates $29,000 of General Basis Increase to the stock, then D will recognize zero gain on D's final Form 1040 under section 684 on the bequest of the stock to N.

Example 13. D, a United States citizen, acquired real property located in the United States in 1984 for $1,000,000 that had a FMV of $10,000,000 on D's date of death in 2010. D's executor made the Section 1022 Election. D's will devised the real property to D's brother (N), a nonresident alien. Assuming that the General Basis Increase available to the executor of D's estate for allocation is $1,300,000, the executor may allocate up to the entire amount of General Basis Increase to this property. Such an allocation will be deemed to have occurred prior to the deemed sale under section 684. Accordingly, if the executor allocates $1,300,000 of General Basis Increase to this property, D will recognize gain on D's final Form 1040 under section 684 in the amount of $7,700,000 ($10,000,000 of FMV less $2,300,000 of basis) on the devise of the property to N.

Example 14. In 2005, D, a United States citizen, transferred securities with a FMV of $5,000 and an adjusted basis of $1,000 to a foreign trust (FT). The income from FT was payable to D during D's life, but D retained no other right to and no power over FT. At all times after the 2005 transfer through D's death, FT has a United States beneficiary, D (within the meaning of section 679(c)), and D was treated as the owner of FT under section 679(a). D died in 2010 and D's executor made the Section 1022 Election. The FMV of the assets of FT at D's death was $30,000. Notwithstanding that D was the owner of FT under section 679 on the date of death, because the securities were transferred by D in an *inter vivos* transfer to FT over which D retained no other right or power, the securities were not acquired from the decedent and section 1022 does not apply to the securities in FT. Under §1.684–2(e)(1), D is treated as having transferred the securities to FT immediately before D's death, and D must recognize $29,000 of gain on D's final Form 1040 under section 684(a).

.07 *Testamentary Charitable Remainder Trusts.* Section 1.664–1(a)(1)(iii) provides, among other things, that a trust is a CRT if a deduction is allowable under section 170, 2055, 2106, or 2522 and the trust meets the description of a charitable remainder annuity trust or a charitable remainder unitrust, as such terms are described in §§ 1.664–2 and 1.664–3, respectively. A testamentary CRT that otherwise qualifies as a CRT under section 664 and the regulations thereunder, but fails to meet the requirement that a deduction is allowable under section 2055 solely because the decedent's executor makes a Section 1022 Election thus making section 2055 inapplicable to the decedent's estate, will qualify as a CRT under section 664.

SECTION 5. AREAS NOT COVERED BY THIS REVENUE PROCEDURE

This Revenue Procedure does not address the manner in which the executor of the estate of a decedent who died in 2010 makes the Section 1022 Election. For information on making that election, the deadline for making that election and related procedures, and on allocating the decedent's GST exemption to transfers occurring at a death occurring in 2010, see Notice 2011–66.

SECTION 6. EFFECTIVE DATE

This revenue procedure is effective August 29, 2011, the date this revenue procedure was published in the Internal Revenue Bulletin. However, taxpayers may apply the safe harbor in this revenue procedure for prior periods.

SECTION 7. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been submitted to the Office of Management and Bud-

get (OMB) in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) and OMB approval is pending. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The collection of information requirement in this revenue procedure is in section 4.02(3) and section 4.04(1) of this revenue procedure. The collection of information in section 4.02(3) relates to certain documents the executor is required to attach to the Form 8939 if the executor allocates Spousal Property Basis Increase to property that is sold prior to its distribution to the surviving spouse.

The collection of information in section 4.04(1) relates to the requirement that the executor obtain and attach to the Form 8939 the FMV appraisal of certain property acquired from the decedent. This collection of information is necessary for the proper performance of the function of the IRS in the collection of the income tax when the property is later sold by the recipient or other holder of the property. In addition, this collection is necessary to comply with the requirements of section 6018.

We estimate that 7,000 executors of estates of decedents who died in 2010 will make the Section 1022 Election and thus will be required to file Form 8939, and that it will take approximately 8 hours to prepare the documentation. The total reporting burden is estimated to be 56,000 hours.

Books or records relating to collections of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by section 6103.

SECTION 8. DRAFTING INFORMATION

The principal authors of this revenue procedure are Laura Urich Daly, Theresa Melchiorre, and Mayer Samuels of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this revenue procedure, contact Laura Urich Daly, Theresa Melchiorre, or Mayer Samuels at (202) 622–3090 (not a toll-free call).