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# CARRYOVER BASIS: A "DISCREDITED" CONCEPT

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The 1976 Tax Reform Act[1] introduced the controversial concept of carryover basis. This replaced "stepping up" or down the adjusted basis of property to its date of death or alternate valuation date value. A fresh start rule exempted prior appreciation, "changing" the basis of inherited property to its December 31, 1976 value. The concept was so complicated that Jonathan Blattmachr, a co-author of this article, wrote a book about it.[2]

## A. The 1976-1980 Carryover Basis Controversy

Tax professionals soon realized that carryover basis created new complexity to estate administration. A storm of protest arose by many professional groups. The Carter Administration and various "liberal" organizations tried to defend this significant change, proposing a 1978 moratorium and a "fix up." But the rapidly strengthening opposition's refusal to compromise and insistence on repeal was overwhelming.



[1] P.L. 94-455.

[2] McGrath & Blattmachr, *Carryover Basis Under the 1976 Tax Reform Act* (Journal of Taxation 1977).

During a dialogue between panelists[3] and committee members at a 1979 House Ways and Means Committee hearing, it was apparent that those strongly favoring repeal; namely, Republicans led by senior minority member, Barber Conable, and conservative Democrats, including Sam Gibbons, were far more articulate and convincing than Committee Chair, Al Ullman, and the handful of liberal Democrats favoring fix up. Retroactive repeal was enacted, but the President threatened a veto. However, an oil supply crisis, causing skyrocketing gasoline prices, made a crude oil windfall profits tax a very important Administration priority. Carryover basis opponents attached its retroactive repeal to this veto-proof bill.

## B. A Resurrected Carryover Basis Applies to 2010 Decedents

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA)[4] enacted a modified carryover basis provisions for 2010 deaths, while gradually phasing out the estate and GST taxes, repealing them for 2010 deaths. In 2011, all prior tax law provisions[5] will apply as if EGTRRA had never been enacted.[6]

Unlike the 1976 carryover basis legislation, EGTRRA does not have a fresh start basis rule. Appreciation that accrued prior to enactment of EGTRRA will be exposed to tax. The absence of a fresh start basis rule makes the determination of basis more difficult.

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[3] Among proponents were former Commissioner of Internal Revenue, Donald C. Alexander, former Deputy Assistant Secretary of the Treasury, John Nolan, and distinguished tax attorney, James Lewis, who had previously served as a somewhat lower level in the Treasury. All three were former chairs of the American Bar Association's Tax Section. Among opponents, representing the American College of Probate Counsel (now the American College of Trust and Estate Counsel) as a Regent and its Estate and Gift Tax Committee Chair, was Frank S. Berall (a co-author of this article).

[4] Enacted June 7, 2001.

[5] Section 901(a)(2) of EGTRRA.

[6] Section 902(b) of EGTRRA.

Section 1014(f)[7] makes section 1014(a)'s adjustment to basis, to the value at death or alternate valuation date, inapplicable to 2010 decedents' estates. However, persons who die after 2010, when EGTRRA will have expired, will be entitled to the basis adjustment previously allowed by section 1014 as though EGTRRA had never been enacted.

Section 1022 treats property acquired from a 2010 decedent as if transferred by gift, thus carrying over its basis. Although the legislative history of the EGTRRA indicates that the nature of any gain or loss that would have been realized by the decedent's sale of inherited property also carries over to the decedent's estate, it is not clear that the statute supports this conclusion. The fact that the property is treated as received by gift does not determine the character of the donee's property or the character of the donee's gain. For example, property that was inventory in the hands of the donor may be a capital asset in the hands of the donee. Section 1221 does address the question of whether a work of art or literary composition acquired upon the death of the artist or author in 2010 is a capital asset in the hands of the transferee. Subsection (a)(3)(C) of section 1221 provides that if the basis of the property is the same in whole or in part, as the transferor's basis, determined without regard to section 1022, then the asset is not a capital asset. Section 6018 (c)(5) requires that executors of decedents who die in 2010 file a return disclosing whether the gain on the sale of the property would be treated as ordinary income. However, except for these provisions, the statute does not support the carryover of the character of property to the decedent's estate or beneficiaries.

[7] Added by EGTRRA, § 542.

Section 1221(11) treats gain on the sale of assets that acquired a new basis under section 1014 as long-term gain. During 2010, since section 1014 is not in effect, gains realized within 12 months of a decedent's death will be short term unless a decedent's holding period is "tacked" to the holding period of his estate or other recipient and is treated as being held for at least a year. Tacking is allowed when a person's basis is the same (in whole or in part) as the basis of the person from whom the asset was acquired. If the limited basis adjustments allowed by EGTRRA are not allocated to an asset or not allocated in an amount sufficient to increase the basis of an asset to fair market value on the date of the decedent's death, tacking should be allowed because the basis will be the same (in whole or in part) as the decedent's basis. If the limited basis adjustments are allocated to increase the basis of an inherited asset to full fair market value, it is not clear whether tacking will be allowed.

Unless EGTRRA is extended after 2010, a basis adjustment may be available, even for property acquired from a 2010 decedent's estate, if the asset is sold after 2010. Section 902(b) of EGTRRA provides that the Internal Revenue Code shall be applied and administered to years, estates, gifts and transfers described in subsection (a) of Section 902 as if the provisions and amendments described in subsection (a) had never been enacted. Subsection (a) of section 902 provides that EGTRRA shall not apply to estates of decedents dying, gifts made, or generation skipping transfers after December 31, 2010. If the Code is applied to "years after 2010" as if EGTRRA had never been enacted, then assets acquired from the estate of a decedent who died in 2010 would have acquired a date of death basis under section 1014. On the other hand, if the Code is applied to "estates of decedents dying after 2010" as of EGTRRA had never been enacted, the basis

of assets inherited in 2010 would continue to be determined under the carryover basis rules of EGTRRA.

### C. The $1.3 Million Basis Increase

To ease the application of the modified carryover basis system to small and medium-size estates, a "basic" basis increase of $1.3 million is allowed for the estate of any U.S. citizen or resident, up to fair market value.[8] This adjustment is augmented by the sum of section 1212(b) capital losses and section 172 net operating loss carryovers. The net operating loss carryforward is the same amount that would have been carried over from the decedent's last taxable year to a later one, had he lived. The section 165 "built in" losses are calculated as if the decedent had sold the property at fair market value immediately before death. The additional adjustment for the decedent's "built-in losses" makes it unnecessary in most cases actually to sell assets to realize losses (in order to preserve them for the modified carryover basis system) prior to death.

Non-resident alien decedents are not treated as generously. Their initial basis increase will be limited to $60,000 and no additional adjustment will be allowed for unused built-in losses or loss carryovers.[9] Hence, American taxpayers (and others) who inherit property from a foreign decedent will face more income tax, on average, on the disposition of that property than for inheritances from American decedents. Under prior law, the basis of property acquired from a foreign decedent, even though not subject to United States estate tax, was equal to its estate tax valuation date fair market value, as a general rule.

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[8] Section 1022(b)(2)(B).

[9] Section 1022(b)(3).

These basis adjustments cannot cause an inherited asset's basis to exceed its date of death fair market value.

The rule treating transfers by a U.S. person to a foreign trust or estate as a sale or exchange is expanded to include transfers by a U.S. person or U.S. estate to a non-resident alien individual. The transferor's gain to be recognized is the excess of the transferred property's fair market value over its adjusted basis in his hands. The deemed sale does not apply to lifetime transfers to nonresident alien individuals.

Clarification is needed as to whether section's 1022 basis adjustments will be allowed to reduce gain, particularly where a sale or other taxable transfer occurs before allocations to basis adjustments have been made.

**D. <u>The $3 Million Spousal Basis Increase</u>**

Qualified spousal property receives a $3 million basis increase (but not above date of death fair market value).[10] Qualified spousal property includes an outright transfer to a surviving spouse unless it is a terminable interest. However, interests terminating because the spouses may die in a common disaster are not considered to be terminable interests if the spouses in fact do not die in a common disaster.

Qualified spousal property also includes qualified terminable interest property (QTIP).[11] This is defined identically to section 2056(b)(7)'s QTIP definition; namely, property "which passes from the decedent, and . . . in which the surviving spouse has a qualifying income interest for life . . . [being] entitled to all the income . . . [at least]

[10] Section 1022(c).

[11] Section 1022(c)(5).

annually . . . and no person has a power to appoint any part of the property to any person other than the surviving spouse."[12] For Louisiana, Puerto Rico and other decedents in civil law jurisdictions, a usufruct for life will qualify.[13] However, unlike the federal estate tax requirement, no QTIP election is required for property to become qualified spousal property.

Nor does the latter include a charitable remainder trust, of which the spouse is the only non-charitable beneficiary, because she is not entitled to all its income. The I.R.S.'s regulatory authority could treat both an annuity and such a trust as qualified spousal property.

Certain interests for which an estate tax marital deduction was available under prior law are not considered qualified spousal property eligible for a section 1022(c) $3 million spousal basis step up. For example, a section 2056(b)(5) general testamentary power of appointment marital deduction trust will not qualify if the spouse has a lifetime general power of appointment which may be exercised in favor of anyone other than the surviving spouse. Similarly, an "estate trust," whose remainder goes to the spouse's estate, without requiring any income payment to her would not be qualified spousal property.

Other than QTIPs, terminable interests such as life estates, term of year legacies, annuities (except as provided in regulations), patents and copyrights will probably not

[12] Section 1022(c)(5)(D) treats a specific portion as separate property, limiting that former term to a portion determined on a fractional or percentage basis.

[13] Section 1022(c)(5)(B)(i).

qualify for the $3 million spousal property basis increase.[14] But, a bond, note or similar contractual obligation, the discharge of which would not have the effect of an annuity for life or term of years, will qualify.[15]

## E. QTIP Trusts

While allocation of the $3 million basis increase can be made to property received by a surviving spouse or QTIP trust, how can these assets be identified if the estate is still open and not all assets that could be distributed to the surviving spouse or QTIP trust have been distributed? For example, if the executor allocates the basis increase to $4 million in stock with a $1 million basis and the QTIP's share is at least equal to $4 million, if the executor allocates the $3 million basis adjustment to the stock and sells the stock before funding the QTIP, must the sales proceeds be allocated to the QTIP? Suppose there is cash that could be distributed in satisfaction of the QTIP instead of the assets that have been sold and with respect to which all or part of the $3 million basis increase has been or it is claimed will be allocated? A similar problem was discovered in the 1976 version of carryover basis by Jonathan Blattmachr (one of this article's authors). He could never figure out a perfect way to solve the issue. Repeal of the 1976 carryover basis made it unnecessary for the I.R.S. to address it. However, it may be necessary now.

While there can be a total $4.3 million (plus unused losses) increase in the basis of the property transferred to a surviving spouse, neither the $1.3 million aggregate basis increase (including unused losses) nor the $3 million spousal basis increase can raise the

[14] Section 1022(c)(4)(B).

[15] *Id.*

basis of any property above its fair market value at death. Thus, the executor must determine which assets to use and to what extent to give each a basis increase. With insufficient appreciation to use these adjustments, the excess is lost.

## F. Jointly Held Property

Property owned by a decedent includes jointly owned property, 50% of that held in joint tenancy if the surviving spouse is the only other joint tenant.[16] Where there are additional tenants and the decedent furnished consideration, he will be treated as owner to the extent of his proportion in it.[17] Where the decedent and someone not his spouse acquired property by gift, bequest, devise or inheritance as joint tenants with right of survivorship, the decedent will be treated as owner to the extent of his fractional interest's value.[18] Where the decedent's interest in jointly held property was received by him as a gift, while the surviving joint tenant purchased his interest, there may be difficulties in proving contribution of the purchased property, as well as determining the contribution ratio for the joint property.[19]

## G. Effects on Foreign Spouses

The $3 million spousal basis increase applies to non-resident aliens and non-U.S. citizen surviving spouses' estates, regardless of the surviving spouse's citizenship or

[16] Section 1022(d)(1)(B)(i)(I).

[17] Section 1022(d)(1)(B)(i)(II).

[18] Section 1022(d)(1)(B)(i)(III).

[19] *Id.*

residency.[20] Unlike the estate tax law, where the estate tax marital deduction is permitted only for property passing to a qualified domestic trust or QDOT described in section 2056A, a non-U.S. citizen surviving spouse may enjoy the basis increases under the modified carryover basis rules that a U.S. surviving spouse may enjoy.

**H. Inflation Adjustments** While EGTRRA expires on December 31, 2010, there is a remote possibility that Congress might extend its carryover basis provisions. If so, and the latter do not expire as scheduled, there will be post-2010 inflation adjustments for the $1.3 million basic basis step up, the $3 million spousal basis increase and the $60,000 non-resident alien decedent's step up.[21] But, inflation adjustments to the $1.3 aggregate increase from the 2009 base year will only be in $100,000 multiples. However, aggregate spousal basis increases of $3 million will be increased for inflation in $250,000 multiples. The $60,000 non-resident aliens' aggregate basis increase will be increased for inflation in $5,000 multiples, but cannot be increased by unused loss carryovers or built-in losses.[22]

## I. Other Problems

(1) The "Owned by" Requirement

For property to receive a basis adjustment, it must be both owned by and acquired from the decedent. The "acquired from" requirement is broadly construed. It includes

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[20] Kaufman, *The Estate and Gift Tax: Implications of the 2001 Tax Act*, Tax Analysts Special Report, Tax Notes, P. 949, 952, August 13, 2001.

[21] H.R. 107-37. *See also* §§ 1022(b)(3) and (d)(4). This adjustment for inflation seems irrelevant, since carryover basis expires December 31, 2010.

[22] Sections 1022(b)(3) and (d)(4).

acquisitions by bequest, devise and inheritance, as well as property passing to his estate, from his revocable trust or any other trust he had the power to alter, amend or terminate and any other property passing from him because of his death, to the extent it passed without consideration.[23] However, the "owned by" requirement is given a narrower meaning. Assets held by a trust will satisfy the "owned by" requirement only if the trust is a qualified trust under section 645(b)(1) so it may, by election, be treated as part of the decedent's probate estate for income tax purposes. Property over which a decedent had a general power of appointment is not treated as his; thus if he has the right to withdraw assets from a trust established by someone else, he will not be treated as owning them for section 1022 purposes. It is at least arguable that assets owned in a trust that is treated as a grantor trust for income tax purpose of which the decedent was the grantor will qualify for a basis adjustment because it is the official position of the I.R.S. that such as trust does not exist for income tax purposes but it treated as owned by the grantor.[24]. But the specific reference to section 645 trusts as meeting the "owned by" requirement implies that other grantor trusts do not meet the "owned by" requirement. This uncertainly may create some pressure for trustees to make distributions to terminally ill beneficiaries, or to exercise withdrawal rights.

The surviving spouse's half share of community property is considered as having been owned by and acquired from the decedent if at least half of the community interest is treated as owned by and acquired from the decedent, without regard to this provision.

[23] H.R. 107-37 and §§ 1041(b)(2) and (3).

[24] Rev. Rul. 85-13, 1985-1 C.B. 142.

This rule is consistent with the benefit community property has enjoyed over jointly held property in determining the basis of assets acquired from a decedent under section 1014.

(2) Negative Basis Property.

Liabilities exceeding basis will be disregarded in determining a transferee's adjusted basis and whether gain is realized at death by the decedent or in a transfer to his estate or to any beneficiary other than a "tax exempt" one.[25] A beneficiary inheriting carryover basis property subject to a liability exceeding basis may incur tax on its subsequent disposition in an amount that could exceed its value. Thus, he should consider disclaiming it.[26]

If property subject to liabilities in excess of basis is left to a charity, a foreigner or, to the extent provided by regulations, to any other person for a tax avoidance purpose, gain is realized by either the decedent at death or by the estate when it distributes the property. A deduction for the distribution would only shield the tax liability to the extent of the value of the property distributed. However, if such property passes to a domestic trust that has no other assets, the collectability of the tax on the eventual sale of the asset subject to liabilities in excess of basis is doubtful.

(3) Property Received Within Three Years of Death

In general, property given to a decedent within three years of death will not qualify for a basis adjustment. However, transfers within three years of death from a

[25] Section 1022(g).

[26] As a general rule, disclaimed property passes to alternate takers, which may eventually mean those who take under the intestate laws of the decedent's domicile and, if all individual takers disclaim, to the state of the decedent's domicile which would be a tax exempt entity which would cause the decedent to recognize the gain as of time of his death.

spouse do qualify for a basis adjustment unless the donor spouse acquired the property by gift from another person within the 3 year period.

(4) Income in Respect of a Decedent

As under section 1014, no adjustment to basis is allowed for income in respect of a decedent ("IRD") principally dealt with under section 691 including traditional IRAs, section 401(k)s and similar tax deferred retirement plans.

(5) Satisfying Pecuniary Bequests with Carryover Basis Assets

Section 1040 provides that only post-death appreciation is recognized by an estate if a pecuniary bequest is satisfied with appreciated carryover basis property. To the extent provided in regulations, a similar rule will apply to trusts. Until then, revocable trusts should make a section 645 election to be treated and taxed as an estate, which will permit the trust to avoid gain recognition pursuant to section 1040 while the election is effect. Section 1040 seems to exempt IRD from being recognized when satisfying a pecuniary bequest, unless there has been an increase in value since death. This is based on a literal reading and may have been unintentional. A beneficiary's basis will be the transferor's basis immediately prior to transfer, plus the gain recognized by the estate or trust on the transfer. Thus, selection of assets to fund pecuniary bequests will significantly affect the beneficiary's future income tax liability, potentially resulting in a significant gain at a later sale or other taxable disposition. A "boilerplate" provision allowing pecuniary bequests to be paid in cash or in kind and without regard to basis in the discretion of the executor could, under a carryover basis regime, distort a decedent's

estate plan, such as where the decedent bequeathed a specific sum to an individual and intended the legatee to receive that amount without any inherent income tax liability.

(6) Principal Residences

The $250,000 exclusion under section 121 on the sale of a principal residence will be extended to estates and heirs, if the residence was used by the decedent as such for two or more years during the five years before its sale. There can be tacking of the decedent's occupancy period to that of the individual beneficiary's in determining if the two-year rule is fulfilled, even if the residence was owned by a trust during the decedent's occupancy.[27] However, this exclusion is allowed only to an estate or an individual beneficiary and not to a trust. Therefore, sales should be made before funding a testamentary trust. A revocable trust making a section 645 election to be taxed as an estate should also be able to use this exclusion while the election is in effect.

(7) No basis adjustment or credit is allowed for state and foreign death taxes.

This is a particularly harsh consequence for U.S. citizens residing abroad. Not only may assets have to be sold to pay foreign death taxes without an income tax "credit" for the foreign death tax, but state death taxes may present the same problem.

## J. Information Returns, Other Estate Administration Problems and Risks to Executors

[27] Conference Committee Report (H.R. CONF. REP. No. 107-84), hereafter H.R. 107-84. The report refers to the beneficiary as an "heir," which could be limited to an intestate beneficiary, but this was probably not the intent.

An as yet not designed information return, in lieu of a United States estate tax return, is required to report large transfers at death.[28] All property (other than cash) acquired from a decedent with a fair market value at death exceeding the $1.3 aggregate basis increase (without increase for unused built-in losses and loss carryovers) will require the executor to file such a return reporting large transfers at death.[29] This filing requirement also applies to appreciated property acquired by the decedent within three years of death, for which the donor was required to file a gift tax return.[30] Basis increase allocations must be made by the executor on an asset by asset basis, on that return, for 2010 deaths. Allocation can be made to one or more shares or to an entire block of stock, but an asset's basis cannot be adjusted above its fair market value on date of death.

The return must report, to both the I.R.S. and the beneficiaries, the recipient's name and tax identification number (TIN), the property's accurate description, its adjusted basis in the decedent's hands, its fair market value at his death, his holding period, sufficient information to determine whether any gain on its sale is ordinary income, the amount of basis increase allocated to the property and any other information prescribed by not yet proposed regulations.

The return must be filed if the aggregate value of these assets (excluding cash) exceeds $1,300,000. If the executor cannot make a complete return, then every person holding any legal or beneficial interest in the property must file one.[31] For non-resident

[28] See section 6018.

[29] As specified in § 6018(c).

[30] Section 6018(b)(2).

[31] Section 6018(b)(4).

aliens' estates, the return requirement applies only to tangibles situated in the United States and other property acquired from that decedent by a U.S. person.

All return preparers must furnish a written statement to each beneficiary with the name, address and phone number of the person required to make the return and the information called for about the decedent's property passing to that person, no later than 30 days after the return is filed.[32] These returns are required when the federal income tax return for the decedent's last taxable year is due to be filed. This would be April 15, 2011 or as late as October 15, 2011, if extensions to file are requested. (Thus, the I.R.S. has a long time before it must release form return.) There is a $10,000 late filing penalty against the executor and a $500 penalty for each failure to furnish the section 6018(b)(2) information concerning certain gifts received by a decedent within three years of death. Furthermore, a $50 penalty will be imposed for failure to furnish statements to the recipients.[33] A reasonable cause exception exists for failure to comply with these requirements.

Administration of 2010 decedents' estates will be complicated by allocation of basis adjustments. Determining optimum allocation may not be the fairest way of doing that under general fiduciary principles. The fairness of an allocation will probably be disputed and possibly litigated between beneficiaries. Even relatively small estates will have to appraise hard-to-value and not readily marketable assets.

The lack of a decedent's records will require extra time to reconstruct basis, particularly for jewelry, collectibles and similar items of tangible personal property

[32] Section 6018(e).

[33] Sections 6716(b) and 6019(b).

purchased in small quantities over a lifetime. The reporting requirements and dealing with disputes between beneficiaries over exemption allocations may increase the risk of surcharge actions, malpractice suits against attorneys for alleged mishandling of allocations or violations of fiduciary duties in making them. An executor who is also a beneficiary will have conflicts of interests in allocating potential basis increases and may be accused of violating his duty of loyalty to the estate.

It is likely that the I.R.S. will have enforcement problems. It is unclear if and when the as yet to be designed return, upon which basis allocations and other information must be reported, will be audited or what penalties will apply in the event of a valuation dispute. If sales occur decades after a 2010 death, can the seller rely on the return's data? Until statutes of limitations run on income tax returns on which beneficiaries report the sale or other taxable disposition of property acquired from a decedent, the disclosures on the executor's information return can apparently be questioned by the I.R.S., even many years after the estate was closed and the executor discharged or died or if a bank that was executor is no longer in business.

## K. Planning

While carryover basis will only have an impact on decedents dying in 2010, unless Congress extends it, the impact of it on estate planning must nonetheless be considered.

One solution for clients with assets without a readily ascertainable basis would be to estimate basis and sell them while alive. Then, in a possible audit, it might be easier for the taxpayer than for his executor to negotiate a favorable settlement. Another

advantage of selling assets while alive would be to eliminate costly difficulties for the executor and the accompanying uncertainty beneficiaries may experience while the basis issue is disputed with the I.R.S. Another solution for a client concerned about dying during 2010 with an asset without basis records would be to give it to a charity for its charitable purposes.

Provisions to protect executors should be drafted into the instruments to exonerate them from liability for asset allocation. Naming a corporate executor, or even co-executor, if the latter is solely responsible for the allocations, should reduce accusations of conflicts of interest.

Engagement and advice letters should alert clients to carryover basis problems that their estates will face if they die this year or if carryover basis is extended beyond 2010. They should be advised to determine the basis of existing property to the extent possible and urge maintenance of proper records of all future acquisitions and additions, as well as request the client's permission to review instruments to deal with possible his death in 2010. Some attorneys may wish to ask the client to sign and return the letter to establish that the attorney gave this advice.

## L. Unresolved Questions

1. Will the basis of assets inherited in 2010 be adjusted to date of death fair market value when EGTRRA expires and the Code is applied to years after 2010 as if EGTRRA had never been enacted, i.e., as if section 1014 had never ceased to apply? If so, where possible, sales of assets in these estates should be delayed until after 2010. s.

2. Is the nature of a decedent's gain (e.g., ordinary income or capital gain) carried over? If the decedent was a dealer, will the estate have to treat the property as inventory rather than a capital asset? There is no definitive rule contained in section 1022 that says that the nature of the gain will remain the same in the hands of the inheritor as it was in the decedent's hands.

3. It should be noted that the legislative history of EGTRRA indicates that the character of the income to the decedent determines the character of the income to the estate or beneficiary who inherits the asset from the decedent. Specifically, "[t]he character of any gain or loss on the sale of an asset is also carried over with its basis. For example, depreciated real estate, which would have been subject to 'recapture' tax had it bee sold by the decedent, will be subject to such recapture if sold by his estate."[34]The statute, however, as mentioned, does not appear to include language that requires this result. For example, if the decedent was a dealer, is the inventory later sold by the decedent's estate ordinary income to the estate, as it would be to the decedent? Nothing in the statute mandates that result.

4. While it does not appear to have been intended, it seems that section 1040 excuses recognition of income as IRD, if used to satisfy a pecuniary bequest. Will this be allowed?

## M. Possible Congressional Action

Senate Majority Leader Harry Reed and Minority Leader Mitch McConnell have discussed trading Republican votes for a jobs bill for Democratic votes to restore the

[34] H.R. 107.37.

2009 estate tax rates of 45% on estates over $3.5 million along with reinstating the estate tax retroactive to January 1, 2010. Retroactive legislation may lead to litigation by estates challenging the constitutionality of apply the reinstated tax to the estates of decedents who died prior to enactment. Unfortunately, however, there is yet no indication whether carryover basis will also be retroactively repealed.

## N. Conclusion

However Congress deals with the absence of estate and GST taxes for 2010 decedents, it may once again consider the retroactive repeal of carryover basis. The cost of administering the carryover basis rules both to the I.R.S. and taxpayers may exceed its revenues. Because many more people will be affected by the carryover basis provisions than would be affected by an estate tax with a $3.5 million exemption, Congress might be able to curry political favor by retroactively reenacting the estate tax with such an exemption and repealing the carryover basis provisions.