



THE EFFECT OF IRS REVENUE RULING 2023-2: THE END OF STEP-UP IN BASIS FOR IRREVOCABLE TRUSTS

By Herman S. Chatrath

In March 2023, the Internal Revenue Service (“IRS”) issued Revenue Ruling 2023-2, definitively stating that assets in irrevocable grantor trusts do not receive a step-up in basis (i.e., an adjustment of the value of an asset) when the grantor dies. This ruling clarifies a previously ambiguous area of tax law and carries significant implications for estate planning strategies. This article will examine IRS Revenue Ruling 2023-2 and the impact it will have on estate planning.

Understanding Trust Options

Most clients are familiar with revocable trusts, as they represent the majority of family trusts created each year. These arrangements allow the trustor to modify or cancel the trust during their lifetime. An irrevocable trust, in contrast, represents a legal arrangement where the grantor permanently transfers assets into the trust, relinquishing ownership and control. Once established, the terms generally cannot be reversed without beneficiary consent or court approval.

When considering whether an irrevocable trust might be appropriate, clients should understand key aspects of these arrangements:

1. Asset protection benefits that shield property from creditors and legal judgments;
2. Potential estate tax reduction by removing assets from the grantor's taxable estate;
3. Permanent transfer of control that limits the grantor's ability to modify the arrangement; and,
4. Complex tax treatment that requires careful planning and expert guidance

The Step-Up in Basis: A Valuable Tax Benefit

A step-up in basis is a valuable tax provision that adjusts the value of an inherited asset to its fair market value at the time of the owner's death. It sets the value of the asset as of the time of the grantor's death instead of its value on the date of acquisition. This adjustment can significantly reduce capital gains taxes when beneficiaries eventually sell the asset. Prior to this ruling, uncertainty existed regarding whether assets in irrevocable grantor trusts received this beneficial treatment.

Implications of Revenue Ruling 2023-2

The IRS has now clarified that assets in these trusts maintain their original cost basis rather than receiving a step-up when the grantor dies. Consequently, beneficiaries will likely face higher capital gains taxes when selling these assets in the future. This effectively eliminates what was previously considered a potential tax advantage of holding appreciated assets in these trusts until death.

Reassessing Estate Planning Strategies

This development necessitates a reconsideration of estate planning strategies that relied on irrevocable grantor trusts for tax efficiency. Clients who implemented such arrangements with the expectation of a basis step-up may need to explore alternative approaches to achieve their financial and legacy objectives.

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