

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
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Legend:

Taxpayer =
Mother =
W =
Z =
City =
State =
Court =
Q =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =
Date 6 =
R location =
\$S =
\$T =
\$U =
\$V =
\$Y =

Dear :

This is in response to your February 11, 2003, submission in which you requested a ruling on behalf of Taxpayer regarding the basis of certain real estate acquired by Taxpayer from her mother's estate through the exercise of an option.

According to the facts submitted, Taxpayer's mother, Mother, and Taxpayer's incompetent sister, W, both resided in a house at R location in City, State. Mother was the sole owner of the house and had resided there for approximately Q years. At no time was the house used for rental or business purposes.

On Date 1, Mother executed her Last Will and Testament. On Date 2, Taxpayer was appointed guardian of W. On Date 3, Taxpayer moved into Mother's house to assist with the care of Mother and W. Mother died a few months later, on Date 4. R location was valued at \$Y for estate tax purposes.

Item IV of Mother's will contains the following provision: If at the time of my death [Taxpayer] is guardian of the person and estate of my daughter [W], I direct that Taxpayer will have the option to purchase the house at R location, City, State for \$S. At that time of Mother's death, Taxpayer was the guardian of W.

On Date 5, pursuant to the option created under Item IV of Mother's will, Taxpayer purchased the real estate located at R location, City, State, from the estate of Mother. Although the option price provided in the will was \$S, the estate allowed the option to be exercised for \$T.

A ruling is requested that the unadjusted basis of the real estate at R location acquired by Taxpayer from Mother's estate is \$U, determined as the sum of the following: (1) the basis of the option under section 1014(a) of the Internal Revenue Code computed at the fair market value of the option property at the date of Mother's death of \$Y less the option price of \$S; plus (2) the actual option price paid of \$T.

Section 2001(a) imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Under section 1014(a) generally, a person acquiring property from a decedent shall have a basis in the property, if not sold, exchanged, or otherwise disposed of before the decedent's death by such person, that is equal to the fair market value at the date of death.

Section 1014(b)(1) provides that for purposes of section 1014(a), property shall be considered to have been acquired from or to have passed from the decedent if the property is acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent.

Rev. Rul. 67-96, 1967-1 C.B. 195, discusses the proper basis of certain shares of corporate stock acquired by an individual through the exercise of an option to purchase the shares from his father's estate for an amount far below the fair market value of the shares. The option was created under the will of his father and bequeathed to him. Citing Cadby v. Commissioner, 24 T.C. 899 (1955), acq. 1956-1 C.B. 3, as authority, Rev. Rul. 67-96 provides that a valuable option created by a

decedent's will has a basis in the hands of the optionee as determined under section 1014(a). In addition, it holds that the basis of such an option may be added to the option price in determining the basis of the property acquired upon exercise of the option.

In this case, Mother's will gave Taxpayer the right to purchase R location for \$S. The right to purchase R location for \$S is a valuable option created by Mother's will to purchase R location for an amount below its fair market value. Based on Rev. Rul. 67-96, we conclude that the option created by Mother's will to purchase R location is property that acquired a basis under section 1014(a) measured by the difference between the value of R location for federal estate tax purposes, \$Y, and the option price, \$S. The basis of the option is therefore, \$V ($\$Y - \$S = \V). Upon exercise of the option, Taxpayer's basis in the real estate is \$U, the sum of the basis of the option, \$V, and the actual option price paid, \$T.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as specifically ruled herein, we express or imply no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

Lorraine E. Gardner
Senior Counsel
(Passthroughs and Special Industries)

Enclosures

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cc: