What Is Cost Basis and How Do You Prove It?

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Knowing the "cost basis" of your property is important for tax purposes but proving cost basis can be difficult. Cost basis adjusts at death, so it is a good idea to appraise property when a joint owner dies.

Cost basis is the monetary value of an item for tax purposes. When determining whether a capital gains tax is owed on property, the basis is used to determine whether an asset has increased or decreased in value. For example, if you purchase a house for $150,000, that is the cost basis. The cost basis can be increased by improvements to the property. If there are no improvements and you later sell the house for $250,000, you will have to pay taxes on the $100,000 increase in value. (However, if the property is your principal residence, you can exclude up to $250,000 in gain, or up to $500,000 for a couple.)

When a property owner dies, the cost basis of the property is "stepped up." This means the current value of the property becomes the basis. For example, suppose you inherit a house that was purchased years ago for $50,000 and it is now worth $250,000. You will receive a step up from the original cost basis from $50,000 to $250,000. If you sell the property right away, you will not owe any capital gains taxes.

When a joint owner dies, half of the value of the property is stepped up. For example, suppose a husband and wife buy property for $200,000, and then the husband dies when the property has a fair market value of $300,000. The new cost basis of the property for the wife will be $250,000 ($100,000 for the wife's original 50 percent interest and $150,000 for the other half passed to her at the husband's death).

The burden is on the property owner to prove cost basis, and it isn't always easy to prove, especially if it has been awhile since the property was purchased or improvements were made. Homeowners should keep good records of improvements to a house, which means keeping receipts and purchase orders. If a joint owner of property dies, you should get the property appraised to show the value at the time it is "stepped up" in basis. Be sure to save the documentation so you can use it later.

For information on cost basis and capital gains on property you inherit, contact Jeffrey Hall, Estate Planning & Elder Law Attorney at www.HallLawGroup.comn or call 925-230-9002 for a free 30 minute consultation.