CLIENT GUIDE COMPLIMENT OF LENNY G LETCHER, EA RFC

When One Arizona Spouse Dies: Who Gets the Basis Adjustment?

A plain-English guide to the 100% community-property basis rule

The short answer: If an asset is qualifying Arizona community property, both halves generally receive a federal basis adjustment when the first spouse dies - not merely the deceased spouse's half.

A little tax humor

> *"Basis" is simply the tax law's way of asking, "How much of this sale price have we already agreed not to tax?" The answer is simple. Finding the paperwork is the adventure.*

Prepared as a general client-education handout only. The Law is ever changing and can void this guide at any time. If you have any questions, call me, or your own tax professional or legal counsel before making any decisions regarding your own property that may be effected by the passing of your spouse.

Current through August 17, 2026

1. The rule most Arizona couples should know

Arizona law generally treats property acquired during marriage as community property unless an exception applies. Federal tax law then supplies a special rule: if qualifying community property is held by the deceased spouse and the surviving spouse, and at least one-half of the whole community interest is included in the deceased spouse's gross estate, the survivor's half is also treated as passing from the deceased spouse for basis purposes.

Practical result: the entire community-property asset generally takes its applicable date-of-death value as its new basis. Key Point: This is true even if no federal estate-tax return is required and no estate tax is owed.

> **Remember:** It can be a step-up or a step-down. If the date-of-death value is below the old adjusted basis, the new basis generally goes down.

2. Stock example: 100 shares of Company A

Assume a married Arizona couple owns 100 shares as qualifying community property.

Item	Per share	Total
Original adjusted basis	$5	$500
Fair market value at death	$10	$1,000
New basis after death	$10	$1,000

Result: all 100 qualifying community-property shares generally have a $10-per-share basis.

What happens when the survivor sells?

Sale price	Proceeds	New basis	Gain/(loss)*
$12/share	$1,200	$1,000	$200 gain
$10/share	$1,000	$1,000	$0
$8/share	$800	$1,000	($200) loss

*Before commissions, other selling expenses, wash-sale rules, or later basis adjustments.

Yes: the later gain or loss is generally based on the actual selling price minus the survivor's newly adjusted basis.

3. Do not confuse community property with joint tenancy

The 100% rule does not arise merely because the owners were married or lived in Arizona. The asset must actually qualify as community property at death. Arizona recognizes several different ownership forms, and the wording on the deed or account can matter greatly.

Ownership form	Typical death-time basis result	What to inspect
Community property/community property with right of survivorship	Both halves generally adjusted	Deed, account title, tracing, agreements
Joint tenancy with right of survivorship	Do not automatically apply the community-property rule	Deed/account title, contributions, state-law characterization
Deceased spouse's separate property	Property passing from deceased spouse generally adjusted	Acquisition history, inheritance/gift records
Survivor's preexisting separate interest	Generally no adjustment merely because the other spouse died	Ownership records and tracing

Property that is commonly separate in Arizona

- Property owned before marriage.
- Property acquired individually by gift, devise, or inheritance.
- The increase, rents, issues, and profits of a spouse's separate property.
- Property acquired with traceable separate funds or exchanged for separate property.
- Property made separate under a valid marital or property agreement.

Client-friendly warning: The words on the deed are not decorative. 'Community property with right of survivorship' and 'joint tenants with right of survivorship' are not interchangeable tax labels.

4. A residence follows the same basic rule

If the home is qualifying Arizona community property, both halves generally receive the basis adjustment. A later sale may also qualify for the separate principal-residence exclusion under IRC section 121.

- A surviving spouse may qualify for an exclusion of up to $500,000 if the sale occurs no later than two years after death and the statutory conditions are met, including the no-remarriage and ownership/use requirements.
- The basis adjustment and the home-sale exclusion are separate benefits: first compute gain using adjusted basis, then apply section 121 if available.
- Also consider improvements, selling expenses, depreciation, rental or business use, and post-death basis adjustments.

5. Important exceptions and special assets

Do not automatically apply the full date-of-death value to every asset. These items require special review:

- Traditional IRAs, qualified retirement accounts, and other income in respect of a decedent (IRD).
- Accrued but unpaid wages, interest, rent, professional fees, and certain installment-sale income.
- Annuities and similar contracts, whose basis rules can differ from ordinary securities.
- Appreciated property given to the decedent by the recipient (or the recipient's spouse) within one year before death and returned to that donor.
- Property subject to alternate valuation, special-use valuation, or federal basis-consistency reporting.

Good practice: Obtain reliable date-of-death values even when Form 706 is not required. Keep the appraisal or brokerage valuation with the permanent tax records.

6. Information to gather before preparing the return

- Date of death and death certificate.
- The couple's domicile when each asset was acquired.
- Deeds, brokerage registrations, trust documents, and marital agreements.
- Purchase dates, original basis, improvements, depreciation, and other basis adjustments.
- Records tracing community and separate funds.
- Date-of-death appraisals or securities valuations.
- Any Form 706, Form 8971/Schedule A, probate inventory, or estate valuation.
- Evidence identifying IRD, retirement benefits, annuities, and installment obligations.

7. The takeaway

For qualifying Arizona community property, the survivor generally receives a basis adjustment on 100% of the asset.

That can dramatically reduce gain on a later sale, but the conclusion depends on the property's actual character, ownership documents, valuation, and special federal exceptions. When the paperwork and the family story disagree, pause and resolve the ownership question before reporting the sale.

Authoritative sources and further reading

1. Internal Revenue Code section 1014 - Basis of property acquired from a decedent

2. Internal Revenue Code section 121 - Exclusion of gain from sale of principal residence

3. IRS Publication 551 (December 2025), Basis of Assets

4. IRS Publication 555, Community Property

5. IRS Publication 523 (2025), Selling Your Home

6. Arizona Revised Statutes section 25-211 - Community property

7. Arizona Revised Statutes section 25-213 - Separate property

8. Arizona Revised Statutes section 33-431 - Community property with right of survivorship and joint tenancy

9. Arizona Revised Statutes section 43-1001 - Arizona gross income begins with federal adjusted gross income

10. Arizona Revised Statutes section 43-102 - Arizona incorporation of federal income and basis principles

Professional-use note

This handout provides general educational information, not legal or tax advice for a particular transaction. Community-property characterization can be fact-intensive. Review the controlling law and current guidance, and involve qualified Arizona counsel when title, tracing, marital agreements, trusts, domicile, or competing ownership claims create uncertainty.