Alternate Valuation Date - A Refresher

Take-Away: Estate taxes can be reduced with an IRC 2032 election. Yet there are many other factors to consider before a knee-jerk 2032 election is made.

Background: A decedent's estate's assets are valued as of the date of death, as a generalization. However, the Tax Code provides an alternate valuation date option. [IRC 2032.] This option allows the Personal Representative of the decedent's estate to make an election to value *all* the estate assets using an alternate valuation date other than the date of the decedent's death. This alternate valuation date can be used to reduce the federal estate that that is due when the aggregate value of the estate assets is *less* six months after the decedent dies than its value at the date of death. Accordingly, an IRC 2032 election can provide an opportunity to save federal estate taxes, but only if its technical rules are satisfied. This alternate valuation date election is often considered when an estate owns real estate or business interests where there is a significant industry or economic downturn shortly after the decedent's death. It can also be used when volatility in the stock markets dramatically affect the value of a decedent's estate.

IRC 2032 Election Conditions: Several conditions must be met to make the IRC 2032 election for a decedent's estate. A summary of the more important rules follows.

Tax Due: The estate must be subject to the federal estate tax, which means that in 2024 the estate must be worth at least $13.61 million, i.e., it must have a federal estate tax liability that is due.

Less in Value 6 Months Later: The value of the decedent's gross estate and the federal estate taxes due must be *less* at the alternate valuation date. [IRC 2032(c).]

All Assets: An aggregate approach is used to value the decedent's estate at these two dates (death and alternate valuation), which means that it is applied to *all* the decedent's assets if the IRC 2032 election is made- there is no 'cherry-picking' of assets that are reported using an alternate valuation- *all* assets receive the alternate valuation date value.

Interim Disposition Value: If some of the decedent's property is distributed, sold, exchanged, or otherwise *disposed* of within the six-month period of the decedent's date of death, the value on the date of transfer is used. [IRC 2032(a)(1).]

No Discounts: No valuation discounts on the date of transfer can be claimed when partial interests are distributed. [Proposed Treasury Regulation 20.2032-1(c)(4)(iv).]

Irrevocable: The IRC 2032 election is *irrevocable* and must be made within one year after the due date, including extensions, of the federal estate tax return. [IRC 2032(d).]

Extensions: In narrow situations the IRS might allow an extension of time in which to make the IRC 2032 election if the estate tax return was filed within one year after its due date, for up to six months, if the IRS finds that the estate acted reasonably and in good faith. [Regulations 301.9100-1-3; 20.2032-1(b)(3).]

Practical Considerations to Making an IRC 2032 Election:

Married Couples: Due to the requirement that the decedent's estate and the federal estate taxes due must be reduced using the alternate valuation, this election is seldom available to a married couple when the first spouse dies, and the unlimited marital deduction is claimed so that no federal estate tax is due. However, the IRC 2032 election might be useful if the surviving spouse makes a timely qualified disclaimer of an interest in the decedent's estate to create a taxable estate.

State Death Taxes: Most states that impose a state estate tax recognize the alternate valuation date election for state estate tax purposes by basing the decedent's gross estate for estate tax purposes off the federal gross estate used for federal estate tax purposes. However, there is only a limited ability to apply the IRC 2032 election with respect to state inheritance taxes that may be imposed.

IRC 6166 Election: The use of an IRC 2032 election could impact the ability of the estate to qualify for installment payments of the federal estate tax. IRC 6166 allows a Personal Representative to defer the payment of federal estate taxes when the estate consists largely of an interest in a closely held business. To make an IRC 6166 election the closely held business must exceed 35% of the decedent's gross estate. An alternate valuation election under IRC 2032 could result in the estate failing to meet this 35% threshold.

Future Income Taxes: We know that assets that are included in the decedent's estate receive an income tax basis adjustment to the asset's date-of-death fair market value, often referred to as a *step-up in* *basis.* [IRC 1014; IRC 754 for partnership assets if an election is made.] The inverse is also true, which is that when assets have gone down in value from their date of acquisition, those assets will have their income tax basis stepped *down* to the date of death or the alternate valuation date under IRC 2032. Consequently, it is possible that with an IRC 2032 election, while federal estate taxes will be saved, capital gain taxes will be increased. In short, an assessment of the impact on both federal estate and capital gains taxes will have to be made.

Impact on Beneficiaries: The IRC 2032 election can have a different impact on different estate beneficiaries, which in turn may trigger questions about the Personal Representative's fiduciary duty to treat beneficiaries impartially.

Example: Elmer's estate bequeaths a $10 million asset on the date of his death to his daughter Mary. However, six months after Elmer's death that same asset Mary is to receive is now worth only $5.0 million. Elmer's estate also bequeaths to his son Todd an asset worth $10 million, but six months later this asset to be distributed to Todd is now worth $10.25 million. While the Personal Representative of Elmer's estate is inclined to make an IRC 2032 alternate valuation date election to reduce federal estate taxes that are owed, that election will increase the long-term income taxes of Mary (her tax basis in her asset will be $5.0 million) while reducing the long-term income taxes of Todd (his income tax basis in his asset will be increased by $250,000.)

Estate Tax Allocation: The decision to make an IRC 2032 election will depend on how the decedent's testamentary instrument directs the payment of federal estate taxes. Will the decedent's Will direct that all federal estate taxes be paid 'off the top' or will federal estate taxes be equitably apportioned among the estate beneficiaries allocated by the fair market value of the assets used for federal estate tax reporting purposes that each receives from the decedent's estate?

Charitable Bequests: Additionally, if there is a charitable bequest from the decedent's estate, an IRC 2032 election to use an alternate valuation date could impact the charitable bequest, again implicating the Personal Representative's fiduciary duty to treat all beneficiaries fairly.

Conclusion: As the 2017 Tax Act nears and dealing with federal estate taxes becomes more and more of a reality we must face, we need to start to re-familiarize our knowledge of Tax Code provisions that might be available to reduce federal estate taxes, IRC 2032 being just one, and start to assess the impact of such an election and how it might implicate fiduciary duties to different beneficiaries.

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