

Alternate Valuation – Useful Estate Tax Valuation Provision

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Overview

The dramatic drop in the stock market over the last month has taken its toll on investments intended for use during retirement years. For example, the Dow Jones peaked at 29,551.42 on February 12, 2020, but had dropped to 20,188.52 at the close on March 16, 2020. This can cause a difficult tax issue for a decedent's estate that faces federal estate tax liability by having the potential to trigger a higher than anticipated tax burden. But, there's a valuation provision in the tax Code that can be beneficial – alternate valuation of [I.R.C. §2032](#).

The alternate valuation provision for a federally taxable estate – it's the topic of today's post.

Valuation Basics

In general, property is valued for federal estate tax purposes as of the date of death. [I.R.C. §2031\(a\)](#). Unless an extension is filed, a federal estate tax return is due nine months after the date of the decedent's death. However, the executor can make an election to value the estate within six months after death *if the value of the property in the gross estate and the estate's federal estate tax liability* (including any generation-skipping transfers payable by reason of the decedent's death – *Treas. Reg. §20.2032-1(b)(1)*) *are both reduced by making the election.* [I.R.C. §2032\(c\)](#); C.C.A. 201926013 (May 30, 2019). This is known as an alternate valuation election, and the election causes the estate's property to be valued at six months after death or earlier if the property is disposed of before the end of the six-month period. [I.R.C. §2032\(a\)](#). In other words, property distributed, sold, exchanged or otherwise disposed of within six months of the decedent's death is valued as of the date of the distribution, sale, exchange or other distribution. [I.R.C. §2032\(a\)\(1\)](#); *Treas. Reg. §20.2032-1(a)(1)*. Any property not so disposed of is valued as of six months after death. [I.R.C. §2032\(a\)\(2\)](#). Post-death value changes due merely to a lapse of time are ignored and the date-of-death value is used. [I.R.C. §2032\(a\)\(3\)](#). If there is no numerically corresponding date six months after the decedent's death, the alternate valuation date is the last day of the sixth month after death. *Rev. Rul. 74-260, 1974-1 CB 275*. For example, if the date of the decedent's death was August 31, the correct alternate valuation date would be February 28 (or 29).

The election doesn't create a direct issue with filing the federal estate tax return – it's not due until nine months after the date of death. The only issue involved might be the shorter timeframe to get the estate assets valued if the election to use the alternate valuation date is made. Also, if the election is made, it is irrevocable (with a limited exception) and applies to all of the property included in the decedent's gross estate. [I.R.C. §2032\(d\)\(1\)](#); *Treas. Reg. §20.2032-1(b)(1)*. The election cannot be used as to only a portion of the property in the decedent's estate. *Id.*

Income tax basis issues. If an alternate valuation election is made, the income tax basis of property that is acquired from the decedent is its value as of the applicable valuation date under the alternate valuation rules. [I.R.C. §1014\(a\)\(2\)](#); *Treas. Reg. §1.1014-3(e)*. The adjusted basis of the property is the value as of the alternate valuation date, less any depreciation allowed or allowable from the time of the decedent's death. *Rev. Rul. 63-223, 1963-2 CB 100*. If the estate extracts



minerals and sells them during the alternate valuation period, gain or loss on sale is tied to their “in place” value on the date of sale (i.e., the alternate valuation date) without any reduction for depletion. *Rev. Rul. 66-348, 1966-2 CB 433, as clarified by Rev. Rul. 71-317 CB 328.* The “in place” value pegs the adjusted income tax basis.

Valuing deductions. With an alternate valuation election in place, the decedent’s estate is not entitled to an estate tax loss deduction for the amount by which an item of property included in the estate was reduced by virtue of the election. *Form 706 instructions, p. 34 (Aug. 2019 version).* If a set percentage of the decedent’s adjusted gross estate is bequeathed to charity, the estate’s charitable deduction is determined by using the value of the decedent’s adjusted gross estate as of the alternate valuation date. *Rev. Rul. 70-527, 1970-2 CB 193.* The same rule (in terms of using the alternate valuation date) applies to determining the amount of any marital deduction. [I.R.C. §2032\(b\)](#); *Treas. Reg. §§20.2032-1(g); 20.2056(b)-4(a).*

An alternate valuation election can be coupled with a special use valuation election. *Rev. Rul. 83-31, 1983-1 CB 225.*

Application of the Alternate Valuation Election

As indicated above, the decedent’s gross estate must be a taxable estate. *Treas. Reg. § 20.2032-1(b)(1) (1958); Tax Reform Act of 1984, Sec. 1923(a), 98th Cong., 2d Sess. (1984).* The purpose of making an alternate valuation election is to lessen the federal estate tax burden if values decline in the six-month period immediately following death. Consider the following example:

Example: Marcia, a widow, died on September 16, 2019, with a taxable estate of \$15 million. At the time of her death she had an available estate tax exclusion of \$11.40 million. Assume that the federal estate tax liability of Marcia’s estate, if her estate were valued as of the date of death, would be \$1,440,000. Marcia’s estate consisted largely of publicly traded stock and, given the stock market plunge, was valued at \$12 million on March 16, 2020 – six months after the date of her death. If the executor of Marcia’s estate elected alternate valuation, the resulting federal estate tax would be approximately \$240,000. The election save’s Marcia’s estate \$1,200,000 in federal estate tax.

As noted above, non-taxable estates cannot make an alternate valuation election. If an estate would not be subject to federal estate tax, an alternate valuation election could allow the estate’s heirs to obtain a higher income tax basis on property included in the gross estate if values had risen after death. That’s because of the income tax basis rule specifying that an asset included in a decedent’s estate receives an income tax basis equal to the asset’s fair market value in the recipient’s hands as of the date of death. Eligibility for an alternate valuation election requires that both the taxable value of the estate decline by making the election and the estate tax liability decline. If the value of the taxable estate drops during the six-month post-death period due to expenses being paid, no separate deduction is allowed for the expenses in computing the taxable estate. [I.R.C. §2032\(b\).](#)

The election is made by checking “Yes” on line 1 of Part 3 of Form 706 (the federal estate tax return) that is filed within one year after its due date (including extensions). [I.R.C. §2032\(d\)\(2\)](#); *Estate of Eddy v. Comr., 115 T.C. 135 (2000).* Thus, the election may only be made on the last estate tax return filed on or before the due date of the return (including extensions of time to file actually granted) or, if a timely return is not filed, the first estate tax return filed after the due date, provided the return is filed no later than one year after the due date (including extensions of time to file actually granted). *Treas. Reg. §20.2032-1(b)(1).* Application for an extension of time to make the election, or a protective election, can be made after the expiration of the one-year period from the return’s due date if the return is filed no later than one year after the due date (including

extensions). *Preamble to TD 9172, Jan. 3, 2005*. A protective election allows the alternate valuation date to be used if it is subsequently determined that the transfer taxes upon death will be lower based on the alternate valuation rather than based on the date of death value of the gross estate. See, e.g., *C.C.A. 201926013 (May 30, 2019)*.

When an alternate valuation election is made, the Form 706 must include: (1) an itemized description of all property in the estate on the date of death and the value of each item on that date; (2) an itemized disclosure of all distributions, sales, exchanges and other dispositions of property, and the date of each, during the six month period after the date of death; and (3) the value of each item of property on the valuation date under the election. Interest and rents accrued as of death and dividends declared on or before death that aren't collected as of the date of death are to be separately stated. *Treas. Reg. §20.6018-3(c)(6)*. Dispositions of estate property during the six-month post-death period must be substantiated. See, e.g., *Treas. Reg. §20.6018-4(e)*.

The Matter of “Included” and “Excluded” Property

For most businesses, alternate valuation is straightforward. There is one value as of the date of death and a different value six months after death. However, in an agricultural estate many things occur during the six-month period immediately following the decedent's death. For example, a decedent may have planted a crop shortly before death, which was harvested and sold within six months after death. Or perhaps the decedent had cows that were bred before the date of death and calved after death and were sold after the six-month period following death. When an alternate valuation election is made, not included in the estate's valuation are any items that are income that the estate's assets produce after the decedent's death.

Help in determining whether these types of property are subject to alternate valuation invokes the concepts of “included” and “excluded” property. Included property is all property that is in existence at death that is part of the decedent's gross estate. Included property is valued six months after death or as of the date of sale, whichever comes first. *Treas. Reg. §20.2032-1(d)*. Thus, crops that are growing as of the date of death and are harvested and sold after death are valued as of the earlier of six months after death or the date of sale. Likewise, leased real estate or personal property and rents accrued to the date of the decedent's death are included property. The underlying property and the accrued rents are to be valued separately. Rental amounts that accrue post-death and before the alternate valuation date are excluded property. If rent is paid in advance, it is to be treated similarly to advance payment of interest on obligations. *Treas. Reg. §20.2032-1(d)(2)*.

Excluded property is property that is excluded from the gross value of the decedent's estate under the alternate valuation election. Thus, income that is earned or accrued (whether received or not) after the date of the decedent's death and during the alternate valuation period with respect to any property interest existing at the date of death is excluded property. This is the result unless such property is a form of included property itself or it represents the receipt of included property. *Treas. Reg. §20.2032-1(d)*. For example, crops that are planted after death are ignored for purposes of alternate valuation. For property that exists as of the date of death and is disposed of gradually during the six-month period after death (such as silage that is fed during the six-month period following death), every day's feeding is a disposition. Thus, a calculation must be made not only as to the value, but as to how much disappeared. The same is true of shelled corn, hay, or similar items. The inventory must show the disappearance over that time period, and some value must be attached to it.

Conclusion

The recent and dramatic decline in the stock market provides an opportunity for substantial estate tax savings for estate with the “right” set of facts. It’s all a matter of timing. For the time being, alternate valuation is “in vogue.”

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