Abstract: Those who have money invested in the stock market are well aware of potential volatility. Needless to say, this volatility can affect a person's net worth. Something many investors might not think about is the potential effect on estate tax liability. Specifically, if the value of stocks or other assets drops precipitously after a person's death, estate tax could be owed on value that has disappeared. This article details how an executor can ease estate tax liability in this situation by electing to use an alternate valuation date.

What a difference six months can make

An alternate valuation date can reduce estate tax liability

If you have money invested in the stock market, you're well aware of potential volatility. Needless to say, this volatility can affect your net worth, thus affecting your lifestyle. Something you might not think about is the potential effect on your estate tax liability. Specifically, if the value of stocks or other assets drops precipitously soon after your death, estate tax could be owed on value that has disappeared. One strategy to ease estate tax liability in this situation is for the estate's executor to elect to use an alternate valuation date.

Alternative valuation date eligibility

Typically, assets owned by the deceased are included in his or her taxable estate, based on their value on the date of death. For instance, if an individual owned stocks valued at $1 million on the day when he or she died, the stocks would be included in the estate at a value of $1 million.

Despite today's favorable rules that allow a federal gift and estate tax exemption of $12.06 million, a small percentage of families still must contend with the federal estate tax. However, the tax law provides some relief to estates that are negatively affected by fluctuating market conditions. Instead of using the value of assets on the date of death for estate tax purposes, the executor may elect an "alternate valuation" date of six months after the date of death. This election could effectively lower a federal estate tax bill.

The election is permissible only if the total value of the gross estate is lower on the alternate valuation date than it was on the date of death. Of course, the election generally wouldn't be made otherwise. If assets are sold after death, the date of the disposition controls. The value doesn't automatically revert to the date of death.

Furthermore, the ensuing estate tax must be lower by using the alternate valuation date than it would have been using the date-of-death valuation. This would also seem to be obvious, but that's not necessarily true for estates passing under the unlimited marital deduction or for other times when the estate tax equals zero on the date of death.

Note that the election to use the alternate valuation date generally must be made with the estate tax return. There is, however, a provision that allows for a late-filed election.

All assets fall under alternate valuation date

The alternate valuation date election can save estate tax, but there's one potential drawback: The election must be made for the entire estate. In other words, the executor can't cherry-pick stocks to be valued six months after the date of death and retain the original valuation date for other

stocks or assets. It's all or nothing.

This could be a key consideration if an estate has, for example, sizable real estate holdings in addition to securities. If the real estate has been appreciating in value, making the election may not be the best approach. The executor must conduct a thorough inventory and accounting of the value of all assets.

Estate plan flexibility

If your estate includes assets that can fluctuate in value, such as stocks, be sure your executor knows about the option of choosing an alternate valuation date. This option allows flexibility to reduce the chances of estate tax liability. Contact your estate planning advisor for additional information.

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