Building Block: Understanding the Alternate Valuation Date

When an individual dies, the executor is faced with an important decision that has the potential to impact the taxes owed by the estate and its heirs.[1]

The executor will have the option of valuing the estate on the date of death, or on the six-month anniversary of death -- the "Alternate Valuation Date."

Pick a Date

For estates with substantial holdings in stocks, the use of the Alternate Valuation Date may be an appropriate approach if the executor believes stock prices will be lower than they were on the date of death.

It may seem like an obvious decision and simple choice, but it's not. Here's why.

If the executor selects the Alternate Valuation Date, it may have ramifications for the heirs.

When heirs inherit assets, such as stocks, they may receive a step-up in the cost basis. (If the value of an asset is more than what it was when the original owner acquired it, the heirs received a "step up" in cost basis -- meaning the heir's valuation is reset when the death occurred.)

Market Moves

Let's take a look at a hypothetical example. Let's say Dad bought Out of Date Technologies at $10 per share several years ago. At his death, the stock is worth $35. The executor used the Alternate Valuation Date and due to market movements, six months later, the stock is worth $28.

His daughter, Julie, will inherit this asset and receive a step-up in the cost basis to the value declared by the estate. Let's now assume that Julie sells the stock a short time later at $35.

If the estate used the value on the date of death -- she might owe no capital gains taxes since she is selling the stock at the same price as her cost basis. But, since she received the stock with the lower cost basis - because the executor chose the Alternate Valuation Date, capital gains taxes on the $7 per share gain may be due.[2]

In this example, the estate saved money by electing the Alternate Valuation Date, but the heir was exposed to a lower cost basis and the prospect of paying higher capital gains tax in the future.

Consider & Balance

As the executor thinks through this balancing act, he or she should consider the relative prevailing tax rates for the estate and for the heirs to ascertain what approach may result in the most efficient transfer, net of taxes, to the heirs.

Endnotes

1. The article assumes the deceased has a valid will and has named an executor, who is responsible for carrying out the directions of the will. If a person dies intestate, it means that a valid will has not been executed. Without a valid will, a person's property will be distributed to the heirs as defined by the state law.

2. This is a hypothetical example used for illustrative purposes only. It is not representative of any specific investment or combination of investments.

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