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# WG&L Estate Planning and Administration Service

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## Federal Estate Tax Return: Considering the Alternate Valuation Date Option

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# Federal Estate Tax Return: Considering the Alternate Valuation Date Option

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New York

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For estate tax purposes, assets are generally valued on the estate tax return as of the date of death. However, if the executor elects to use alternate valuation, the assets are *generally* valued as of six months after death.

Alternate valuation is useful if the assets of the estate decrease in value during the six months after death. The use of alternate valuation is governed by Section 2032.<sup>1</sup> This chapter discusses the rules surrounding the election of the alternate valuation date and how the decision regarding its election is made.

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<sup>1</sup> All statutory references are to the Internal Revenue Code of 1986, unless otherwise indicated.

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**M30.1 WHEN IS ALTERNATE VALUATION AVAILABLE?**

Alternate valuation is available if all the following requirements are met.

1. A federal estate tax return must be required.<sup>2</sup> In other words, the gross estate must generally be at least \$600,000.<sup>3</sup>
2. The use of alternate valuation must reduce the gross estate.<sup>4</sup>
3. The use of alternate valuation must reduce the total of the estate tax and the generation-skipping tax.<sup>5</sup>

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**M30.2 HOW TO MAKE THE ELECTION**

Question 1 on page 2 of the federal estate tax return asks, "Do you elect alternate valuation?" To elect alternate valuation, this question must be answered "yes." (See Form M30-1 for a reproduced page 2 of the return.)

Alternate valuation can be elected on a timely filed return or on an original return that is not delinquent by more than one year.

If the election is not made on the original return, it can only be made on a subsequent return if it is filed by the due date of the original return (including extensions).<sup>6</sup> The election, once made, is irrevocable.<sup>7</sup>

If alternate valuation is elected, the values of the assets on both the date of death and the alternate valuation date must be shown (see Form M30-1 in the forms section). The totals filled in on page 1 of the return must be based on alternate valuation.

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**M30.3 WHAT IS THE ALTERNATE VALUATION DATE?**

If you elect alternate valuation date, the assets of the estate are *generally* valued as of six months after death.<sup>8</sup> However, if an asset is sold, exchanged, distributed to a beneficiary, or otherwise disposed of within six months of death, it is valued as of the date it is so disposed of.<sup>9</sup>

If there is no corresponding day in the sixth month after death, then the alternate valuation date for assets not disposed of is the last day of the sixth month. For example, if the decedent dies on March 31, the alternate valuation date is September 30.<sup>10</sup> For this purpose, a tax-free incorporation under Section 351 or a tax-free reorganization under Section 368 is not treated as a disposition.<sup>11</sup> Also for this purpose, property is deemed to be disposed of if a

<sup>2</sup> Reg. § 20.2032-1(b).

<sup>3</sup> I.R.C. § 6018(a)(1). Under Section 6018(b)(4), the \$600,000 figure is reduced by the amount of adjusted taxable gifts made after 1976 and the amount of gift tax specific exemption allowed for gifts made after September 8, 1976.

<sup>4</sup> I.R.C. § 2032(c)(1).

<sup>5</sup> I.R.C. § 2032(c)(2).

<sup>6</sup> Temp. Reg. § 5h.4(b)(1); Rev. Rul. 54-445, 1954-2 C.B. 301.

<sup>7</sup> I.R.C. § 2032(d).

<sup>8</sup> I.R.C. § 2032(a)(2).

<sup>9</sup> I.R.C. § 2032(a)(1). See Wachtel, "Alternate Valuation Date for Estates," 61 A.B.A. J. 1136 (1975).

<sup>10</sup> Rev. Rul. 74-260, 1974-2 C.B. 275.

<sup>11</sup> Reg. § 20.2032-1(c)(1).

binding contract for its disposition is entered into, unless the contract is not subsequently carried out in accordance with its terms.<sup>12</sup>

## M30.4 VALUE AS OF THE ALTERNATE VALUATION DATE

Changes in value that are due to the mere lapse of time are not taken into account for purposes of alternate valuation.<sup>13</sup> Examples of assets that change in value because of the lapse of time are life estates, remainder interests, interests for a term of years, and patents. In the case of life estates, remainders, and similar interests, the ages of the individuals involved are measured as of the date of death, although the underlying property is valued as of the alternate valuation date.<sup>14</sup>

An example may clarify this point. Consider a decedent who owned a patent. As of the date of death, the patent was worth \$78,000 and had a ten-year life span. In other words, it was worth \$7,800 per remaining year. Six months later, when it had a nine-and-one-half-year life span, it was worth \$60,000, or \$6,315.79 per remaining year. In order to adjust for the lapse of time, the alternate value of the patent would be \$63,157.89, not \$60,000.<sup>15</sup>

Property interests existing at the date of death ("included property") and property earned or accrued thereafter ("excluded property") must be distinguished.<sup>16</sup> With an interest-bearing obligation, the principal and accrued interest to the date of death are included, but not the interest accruing after death.<sup>17</sup> Leased property and the rents accrued to the date of death are included.<sup>18</sup> In the case of savings bonds and zero-coupon bonds, the discount is treated as interest.<sup>19</sup>

Shares of stock and dividends declared as of record on or before death are included, but not ordinary dividends out of earnings and profits declared as of record after death. However, if dividends are declared of record after the date of death, with the effect that the shares no longer represent the same "included property," then the dividends are included except to the extent that they are out of post-death earnings and profits.<sup>20</sup> If a stock is trading ex-dividend at the alternate valuation date, the dividend must be added back to determine the value of the stock.<sup>21</sup>

If the decedent owned a life insurance policy on the life of another person, increases in the value of the policy attributable to the payment of premiums or interest earned during the six months after the decedent's death are not included.<sup>22</sup> However, if the insured dies in the interim, the entire proceeds are includable in the policyowner's estate if alternate valuation is elected.<sup>23</sup>

<sup>12</sup> Reg. § 20.2032-1(c)(3).

<sup>13</sup> I.R.C. § 2032(a)(3).

<sup>14</sup> Reg. § 20.2032-1(f)(1).

<sup>15</sup> Reg. § 20.2032-1(f)(2).

<sup>16</sup> Reg. § 20.2032-1(d).

<sup>17</sup> Reg. § 20.2032-1(d)(1).

<sup>18</sup> Reg. § 20.2032-1(d)(2).

<sup>19</sup> Reg. § 20.2032-1(d)(3).

<sup>20</sup> Reg. § 20.2032-1(d)(4); *Estate of J. Schosser v. Comm'r*, 277 F.2d 268, 60-1 U.S.T.C. ¶ 11,939 (3d Cir. 19).

<sup>21</sup> *Estate of C.D. Fleming*, 33 T.C.M. 1414 (1974); Rev. Rul. 60-124, 1960-1 C.B. 368.

<sup>22</sup> Rev. Rul. 55-379, 1955-1 C.B. 449.

<sup>23</sup> Rev. Rul. 63-52, 1963-1 C.B. 173.

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### M30.5 EFFECTS OF ALTERNATE VALUATION ON THE MARITAL, CHARITABLE, AND OTHER DEDUCTIONS

For purposes of the marital and charitable deductions, property is valued as of the date of death, adjusted for any difference in value as of the alternate valuation date. However, no adjustment is made for changes in value due to lapse of time or occurrence or nonoccurrence of a contingency.<sup>24</sup>

Other deductions (e.g., losses under Section 2054 or administration expenses under Section 2053(b)) are not allowable if alternate valuation would, in effect, give allowance for the same item.<sup>25</sup>

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### M30.6 COLLATERAL EFFECTS AND RELATIONSHIP TO OTHER ELECTIONS

Alternate valuation can be used to qualify for Section 303, which allows exchange treatment on certain redemptions. It is available if the estate tax value of the decedent's stock in a corporation exceeds 35 percent of the excess of the gross estate over the deductions allowable by Section 2053 (funeral and administration expenses and debts) and Section 2054 (losses).<sup>26</sup>

Alternate valuation can also be used to qualify for Section 6166, which allows installment payment of the portion of the estate tax that is attributable to the decedent's interest in a closely held business. One of the requirements for a Section 6166 deferral is that the decedent's interest in the business must exceed 35 percent of the adjusted gross estate.<sup>27</sup> Depending on which assets increase or decrease in value, an estate that did not qualify for Section 6166 based upon date-of-death values might qualify under alternate valuation.

Both alternate valuation and the Section 2032A special use valuation can be used.<sup>28</sup>

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### M30.7 RELATIONSHIP WITH THE UNLIMITED MARITAL DEDUCTION

Married individuals often wish to avoid estate tax by taking advantage of the unlimited marital deduction and the unified credit. It would seem that in such a case, alternate valuation would not be available even if the gross estate decreases in value, because alternate valuation is only available if it reduces the tax. However, it is possible to create a nominal tax by appropriate language in the will, a disclaimer by the surviving spouse, or a partial QTIP election, in order to make the alternate valuation available.<sup>29</sup> (See Forms M30-2, M30-3, and M30-4 for sample clauses.)

<sup>24</sup> I.R.C. § 2032(b); Reg. § 20.2032-1(g); Rev. Rul. 70-527, 1970-2 C.B. 103.

<sup>25</sup> I.R.C. § 2032(b); Reg. § 20.2032-1(g).

<sup>26</sup> I.R.C. § 303(b)(2)(A).

<sup>27</sup> I.R.C. § 6166(a)(1).

<sup>28</sup> Rev. Rul. 83-31, 1983-1 C.B. 225.

<sup>29</sup> Steiner, Estate Tax Marital Deduction Planning for Alternate Valuation, 65 J. Tax'n 232 (1986). See Covey, Marital Deduction and Credit Shelter Dispositions and the Use of Formula Provisions (U.S. Trust Company of New York, 1984); Lewis, The Marital Deduction (Practising Law Institute, 1984).

In such a case, the election of alternate valuation may affect the amounts passing to the marital and nonmarital shares of the estate. For example, if the net estate decreases from \$2 million to \$1.6 million and alternate valuation is not elected, the marital and nonmarital shares would be as follows:

<i>Type of Estate Plan</i>	<i>Marital Share</i>	<i>Nonmarital Share</i>
Preresiduary marital	\$1,400,000	\$200,000
Residuary marital	1,000,000	600,000
Fractional share	1,120,000	480,000

However, if alternate valuation is elected, the marital and nonmarital shares would be based on a net estate of \$1.6 million and would be:

<i>Type of Estate Plan</i>	<i>Marital Share</i>	<i>Nonmarital Share</i>
Preresiduary marital	\$1,000,000	\$600,000
Residuary marital	1,000,000	600,000
Fractional share	1,000,000	600,000

Thus, if the unlimited marital deduction is used, alternate valuation can be elected to reduce the marital share of the estate and, ultimately, reduce the surviving spouse's estate.

## M30.8

### **EFFECT OF ALTERNATE VALUATION OF BASIS: THE COST OF ALTERNATE VALUATION**

The advantage of alternate valuation is that it reduces the estate and, hence, the estate tax. (If the unlimited marital deduction is used, the estate tax savings will be in the surviving spouse's estate.)

The trade-off is that, if alternate valuation is elected, the income tax basis of the estate's assets is generally reduced. Under Section 1014(a), the basis in the hands of the estate or beneficiary of property acquired from a decedent is generally the date-of-death value. This is commonly known as a "stepped-up" basis. However, if alternate valuation is elected, the basis is the value as of the alternate valuation date. Because alternate valuation is available only if the gross estate decreases in value, it generally results in a decrease in the aggregate basis of the estate's assets.

In deciding whether to elect alternate valuation, you should compare the estate tax savings from alternate valuation with the income tax cost of the reduced basis. In order to do this, consider the following factors:

1. The estate tax bracket
2. Whether the unlimited marital deduction is available (so that the estate tax savings would occur upon the surviving spouse's death)
  - a. The spouse's life expectancy
  - b. Whether any estate tax will be due on the spouse's estate
3. Whether the assets are depreciable (if yes, the income tax benefits of the depreciation deduction)
4. Whether the assets will be sold by the estate or by the beneficiary during his or her lifetime (if yes, the income tax cost upon the sale)

5. Whether any assets, such as income in respect of a decedent, are ineligible for a stepped-up basis.<sup>30</sup>

These factors should be considered on an asset-by-asset basis, because some assets may increase in value even though the entire gross estate decreases in value.

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### M30.9 ALTERNATE VALUATION AND SECTION 754

As set forth, the estate or beneficiary takes a stepped-up basis in property acquired from a decedent. If the decedent was a partner in a partnership, the partnership may make an election under Section 754 to adjust the basis of its assets with respect to the decedent's estate. In general, the effect of a Section 754 election is to treat the estate as if the decedent had owned a proportionate share of the partnership's assets, rather than simply a partnership interest.

If the partnership makes a Section 754 election, the basis adjustment should be determined based upon the value of the partnership interest as of the alternate valuation date.<sup>31</sup> However, it is not clear whether the adjustment is made as of the date of death or the alternate valuation date.<sup>32</sup>

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### M30.10 ALTERNATE VALUATION AND THE GENERATION-SKIPPING TAX

Under Section 2624, alternate valuation may be applicable to the generation-skipping tax in either of two ways.

1. In the case of a direct skip of property that is included in the transferor's gross estate (e.g., if the decedent left property to a grandchild), then the value of the property for generation-skipping tax purposes is the same as for estate tax purposes. In other words, if alternate valuation is elected for estate tax purposes, it will automatically apply for generation-skipping tax purposes.<sup>33</sup>
2. If there is a taxable termination with respect to a trust upon the death of an individual (e.g., the death of a child who was the income beneficiary of a trust, the remainder of which passes to a grandchild), alternate valuation for the taxable termination may be elected. If this election is made, it applies to all taxable terminations with respect to that trust with respect to the death of that individual.<sup>34</sup>

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<sup>30</sup> I.R.C. §§ 691 and 1014(C).

<sup>31</sup> McKee and co-workers, *Federal Taxation of Partnership and Partners* ¶ 24.08[2] (Warren, Gorham & Lamont, 1977).

<sup>32</sup> *Id.*

<sup>33</sup> I.R.C. § 2624(b).

<sup>34</sup> I.R.C. § 2624(c).



**FORM M30-1 Alternate Valuation Election**

Form 706 (Rev. 11-87)

Estate of:

**Part 3.—Elections by the Executor**

Please check the "Yes" or "No" box for each question.

	Yes	No
1 Do you elect alternate valuation?	X	
2 Do you elect special use valuation? If "Yes," complete and attach Schedule A-1		
3 Do you elect to pay the taxes in installments as described in section 6166? If "Yes," you must attach the additional information described in the instructions.		
4 Do you elect to postpone the part of the taxes attributable to a reversionary or remainder interest as described in section 6163?		
5 Do you elect to have part or all of the estate tax liability assumed by an Employee Stock Ownership Plan (ESOP) as described in section 2210? If "Yes," enter the amount of tax assumed by the ESOP here ▶ \$_____ and attach the supplemental statements described in the instructions.		

**Part 4.—General Information** Note: Please attach the necessary supplemental documents. You must attach the death certificate.

- 1 Death certificate number and issuing authority (attach a copy of the death certificate to this return).
- 2 Decedent's business or occupation. If retired check here  and state decedent's former business or occupation.
- 3 Marital status of the decedent at time of death:
  - Married
  - Widow or widower—Name and date of death of deceased spouse ▶ \_\_\_\_\_
  - Single
  - Legally separated
  - Divorced—Date divorce decree became final ▶ \_\_\_\_\_

4a Surviving spouse's name	4b Social security number	4c Amount received (see instructions)
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5 Individuals (other than the surviving spouse), trusts, or other estates who receive benefits from the estate (do not include charitable beneficiaries shown in Schedule O) (see instructions). For Privacy Act Notice (applicable to individual beneficiaries only), see the instructions for Form 1040.

Name of individual, trust or estate receiving \$5,000 or more	Identifying number	Relationship to decedent	Amount (see instructions)
All unascertainable beneficiaries and those who receive less than \$5,000			▶
<b>Total</b>			

(Continued on next page)

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**FORM M30-2 Pecuniary Marital Bequest to Create  
a Nominal Estate Tax<sup>35</sup>**

If my wife, JANE DOE, survives me, I give and bequeath to my wife, JANE DOE, as a pecuniary legacy, a sum equal to ninety-nine (99) percent of the amount by which the value of the property disposed of by this Will exceeds the aggregate of (i) the value of the property disposed of by the preceding Articles of this Will; (ii) a sum equal to the largest amount, if any, that can pass free of federal estate tax by reason of the unified credit and the state death tax credit allowable to my estate but no other credit, after taking account of property disposed of by previous Articles of this Will and property passing outside of this Will that is includable in my gross estate but does not qualify for the marital or charitable deduction and after taking account of charges to principal that are not allowed as deductions in computing my federal estate tax; and (iii) my debts, expenses of administration, and other charges payable out of principal, including any death taxes, that reduce the value of property disposed of by this Will that may qualify for the marital deduction. For the purpose of establishing the sum disposed of by this Article, the values finally fixed in the federal estate tax proceeding relating to my estate shall be used.

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**FORM M30-3 Partial QTIP Election<sup>36</sup>**

Pursuant to Section 2056(b)(7) of the Internal Revenue Code of 1986, election is hereby made to treat an undivided ninety-nine (99) percent share of the bequest under Article THIRD of the Will as qualified terminable interest property passing to the surviving spouse.

<sup>35</sup> Adapted from Covey, *supra* note 29, 35-36.

<sup>36</sup> Temp. Reg. § 22.2056-1.

FORM M30-4 **Disclaimer by the Surviving Spouse**

In the Matter of the Estate of John Smith, deceased	:	:	BERGEN COUNTY SURROGATE'S COURT
			Docket No. 999999.

**DISCLAIMER**

WHEREAS, John Smith (the Decedent) died on \_\_\_\_\_, 19 \_\_; and

WHEREAS, the Decedent's Last Will and Testament (the Will) was admitted to probate by the Bergen County Surrogate's Court on \_\_\_\_\_, 19 \_\_, and letters testamentary were issued to Jane Smith; and

WHEREAS, in Article THIRD of his Will, the Decedent left a pecuniary legacy to the trustees of the Jane Smith Trust created under the Will for the benefit of Jane Smith; and

WHEREAS, in Article FOURTH of his Will, the Decedent bequeathed and devised his residuary estate to the trustees of the John Smith Family Trust created thereunder, of which Jane Smith is a beneficiary and over which Jane Smith has certain powers; and

WHEREAS, Jane Smith has not heretofore received or accepted any property under the Decedent's Will or any benefits therefrom by reason of any testamentary disposition or by reason of a disclaimer made by another person; and

WHEREAS, less than nine months have elapsed since the Decedent's death; and

WHEREAS, Jane Smith desires to disclaim and renounce a fractional part of her entire interest in the income and principal of the Jane Smith Trust, as well as her entire interest in the principal of the John Smith Family Trust under said Will.

NOW, THEREFORE, pursuant to New Jersey Statutes Annotated 3B:9-1 et seq.:

1. I, Jane Smith, hereby freely, voluntarily, and irrevocably disclaim and renounce my entire interest in an undivided one (1) percent portion of the income and principal of the Jane Smith Trust, including but not limited to the right to receive or appoint the income, and the right to appoint, withdraw, or otherwise receive principal from such undivided portion of the Jane Smith Trust.

2. I, Jane Smith, hereby freely, voluntarily, and irrevocably disclaim and renounce my entire interest in the principal of the John Smith Family Trust, including but not limited to the right to appoint, withdraw, or otherwise receive principal from the John Smith Family Trust (including the right to allocate the enjoyment thereof).

3. This instrument is intended to be a qualified disclaimer under Section 2518 of the Internal Revenue Code of 1954, as amended, and is irrevocable.

4. This instrument shall be governed by Section 2518 of the Internal Revenue Code and by the laws of the State of New Jersey, and shall bind the undersigned, her heirs, executors, administrators, successors, and assigns.

FORM M30-4 (continued)

IN WITNESS WHEREOF, I have signed this instrument this \_\_\_\_ day of \_\_\_\_\_, 19 \_\_\_\_.

\_\_\_\_\_  
Jane Smith, Disclaimant (L.S.)

**STATE OF NEW JERSEY )**  
**) SS**  
**COUNTY OF BERGEN )**

BE IT REMEMBERED, that on this \_\_\_\_ day of \_\_\_\_\_, 19 \_\_\_\_, before me, the subscriber, personally appeared JANE SMITH, who, I am satisfied is the individual mentioned in the within instrument, to whom I first made known the contents thereof, and thereupon she acknowledged that she signed, sealed, and delivered the same as her voluntary act and deed, for the uses and purposes therein expressed.

\_\_\_\_\_  
Subscriber Signature

**Receipt for Disclaimer**

The undersigned, Executrix of the Estate of John Smith, deceased, acknowledges receipt of the foregoing Disclaimer by personal delivery and affirms that the Disclaimant has not accepted the interests disclaimed thereby or any of the benefits thereof.

IN WITNESS WHEREOF, the undersigned has signed this Receipt this \_\_\_\_ day of \_\_\_\_\_, 19 \_\_\_\_.

\_\_\_\_\_  
Jane Smith, Executrix of the  
Estate of John Smith, Deceased