Executor's Post-Death Elections To Reduce Taxes

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The basic goal of post-death tax planning for estates is to reduce taxes for the decedent's estate and the beneficiaries. An executor has many opportunities available for making the right elections that will have a direct impact on the overall tax liability of the estate and beneficiaries. The failure to exploit these opportunities could result in the executor's liability to the estate and beneficiaries for the lost tax savings. A few of the many elections are discussed below.

1. Deducting Estate Administration Expenses. These may be deducted either on the estate's federal estate tax return (Form 706) or on the estate's federal income tax return (Form 1041). This decision is usually made by comparing the marginal estate tax and income tax rates. The election is made by the executor filing a statement with the estate's income tax return stating that the administration expenses claimed on the estate's federal income tax return, Form 1041, have not been taken on the estate's estate tax return and that the executor waives the right to deduct them on the estate's federal estate tax return, Form 706.
2. Medical Expense of Decedent. A medical expense of the decedent paid by the estate within one year after death may be deducted either on the estate's federal estate tax return, Form 706, or on the decedent's federal income tax return for the year the expense was incurred, Form 1040. To deduct the medical expense on the decedent's income tax return, the executor files an election with such return stating the expense has not been taken on the estate's Form 706 and that the executor waives the right to do so. Preferably, the medical expense should be paid before death to remove the funds from the calculation of the estate tax. Where the decedent was incapacitated and unable to handle financial affairs, the agent under the decedent's power of attorney may pay the expense before the decedent's death.
3. Valuation Elections. The executor may choose to value the estate's assets for federal estate tax purposes by using the so-called "alternate valuation date" of Internal Revenue Code ("Code") Section 2032 and valuing certain real estate property under the "special use" rules of Code Section 2032A.

    1. Section 2032 Alternate Valuation Date. Section 2032 generally provides that the value of the estate for federal estate tax purposes, if the executor so elects, may be determined as of six months after the decedent's date of death, provided, however, that both the value of the estate and the federal estate tax are reduced by using the alternate valuation date. The election is made by checking a box on the federal estate tax return, Form 706, on page 2 under the heading "Elections by Executor."

        1. New Jersey Inheritance Tax. The New Jersey Inheritance Tax statute does not provide for the use of an alternate valuation date. Assets must be valued for all inheritance tax purposes at their value on the decedent's date of death.

2. New Jersey Estate Tax. The policy of the New Jersey Division of Taxation is that if an election could have been made under the provisions of the 2001 Internal Revenue Code, that election may be made for New Jersey estate tax purposes. If a federal estate tax return is filed, the same election must be made for New Jersey estate tax purposes. Where a federal estate tax return is neither filed nor required to be filed, the estate may make an election to use the alternate valuation date for New Jersey estate tax purposes provided the election could have been made under the provisions of the Internal Revenue Code in effect on December 31, 2001.

2. Section 2032A Special Use Valuation of Real Estate. Ordinarily, the IRS will value real estate for federal estate tax purposes at a fair market value that represents the property's highest and best use, which often will be a much higher value than the actual use value of a farm or other real estate used in a closely-held trade or business. To remedy this, Congress enacted Section 2032A to permit such real estate to be valued on the basis of its actual use rather than its highest and best use. The purpose of Section 2032A was to encourage the decedent's heirs to continue operating the farm or closely-held business. The maximum reduction in value of the real estate to its actual use value is limited to $750,000, as adjusted for inflation, and for 2014 the reduction in value may not exceed $1,090,000. For example, if the IRS determined that the highest and best use value of real property used as a farm was $3 million dollars, but the farm's actual use value was only $1 million, the Section 2032A valuation election would allow the estate to value the property for federal estate tax purposes at $1,910,000 ($3,000,000 minus $1,090,000), resulting in a potential federal estate tax savings of $436,000 (40% times $1,090,000). Where real property is used as a farm or as part of a closely-held business owned by the decedent, the executor should be aware of this potential tax savings valuation method. Generally, Section 2032A is a tax savings option only for estates holding real property that will continue to be used as a farm or in a closely-held trade or business by the decedent's heirs for years to come.

    1. New Jersey Inheritance Tax. The New Jersey Inheritance Tax statute does not provide for special use valuations for real estate. Assets must be valued for inheritance tax purposes at their fair market value on the decedent's date of death.
    2. New Jersey Estate Tax. If an election could have been made under the provisions of the 2001 Internal Revenue Code to use the special use valuation rules of Code Section 2032A, that election may be made for New Jersey estate tax purposes. If a federal estate tax return is filed, the same election must be made for New Jersey estate tax purposes. Where a federal estate tax return is neither filed nor required to be filed, the estate may make an election to use the special use valuation rules of Code Section 2032A for New Jersey estate tax purposes provided the election could have been made under the provisions of the Internal Revenue Code in effect on December 31, 2001.
    3. Installment Payment of Estate Tax Under Code Section 6166. If a closely-held business, consisting of a corporation, partnership or sole proprietorship,

makes up at least 35% of the value of a decedent's estate, the executor may elect to pay the federal estate taxes on the closely-held business over a fourteen (14) year period, subject to certain requirements.

4. Unused Spousal Exemption Amount. The estate of a decedent is allowed a credit against federal estate tax. Under the Code the credit is referred to as the "applicable exclusion amount." The applicable exclusion amount consists of the "basic exclusion amount," which for 2015 will be $5,430,000 per person, and, in the case of a surviving spouse, also includes a deceased spousal unused exclusion ("DSUE") amount. Thus, the Code allows the deceased spouse's unused exclusion ("DSUE") amount to be transferred to the surviving spouse. This concept of transferring the DSUE to the surviving spouse is known as "portability." The DSUE gets added to the surviving spouse's basic exclusion amount to determine the surviving spouse's applicable exclusion amount. The surviving spouse may then use the combined amounts to reduce taxes for either gift tax or estate tax purposes but not for generation-skipping transfer tax purposes. To transfer the DSUE to the surviving spouse, the executor of the estate of the predeceased spouse must file an election on a timely filed (including extensions) federal estate tax return (Form 706) for the predeceased spouse's estate. Even if no federal estate tax return is otherwise required to be filed for the predeceased spouse, the executor must file the federal estate tax return for the predeceased spouse's estate to compute the amount of the DSUE and to make the election.