Michael Lagos
(866) 444-4964
mlagos@lagosadvisors.com

Bob Langsam
(800) 825-9990
rlangsam@lagosadvisors.com

LAGOS WEALTH ADVISORS
BUILDING, PROTECTING AND PERPETUATING FAMILY WEALTH

Fiduciary Tax Planning- The "AVD"
A Tax Advantaged Strategy for Estate Assets

Section 2032 allows Fiduciaries to choose between the value of estate assets on the date of death, or six months after death, known as the alternative valuation date ("AVD"). For estates holding stock portfolios, and with the markets volatile once again, Fiduciaries should consider keeping open the option of the AVD.

Strategic tax planning for the AVD, can afford Fiduciaries an opportunity to realize substantial tax savings by reducing the higher estate tax rates to the much lower capital gains rate. Fiduciaries are usually reluctant to hold the shares for six more months. They tend to want to sell stock as soon as possible after an owner's death, especially since the shares enjoy a step-up in basis and have no tax consequences to doing so. If a Fiduciary deliberately delayed and the markets encountered a substantial drop, then electing the AVD would soften the blow of a depreciated portfolio but it certainly wouldn't necessarily compensate for a substantial reduction in estate value.

The strategy requires the writing of an "estate option collar" to establish protection on the estate portfolio equal to the value on the date of death. By doing so ***the Fiduciary has set a minimum estate value equal to the value at date of death for a six month period.*** Assuming an estate portfolio valued at $10 million at death declined in value to $7 million, the Fiduciary can take advantage of the AVD, and then exercise the estate option limit of $10 million, resulting in a $3 million gain taxed at the substantially lower capital gains rate.

The result is a unique opportunity to benefit the estate with lower taxation in a period that the market decline would otherwise have cost the estate beneficiaries a substantial loss in their inheritance. Under Section 2032, choosing the AVD for the estate portfolio also means choosing the AVD for all other assets in the estate.

In volatile markets the cost of the estate option protection can be expensive, usually from 8% to as high as 15% of the underlying stock price. To avoid the cost the Fiduciary should consider the "zero cost option collar", creating an upside limit value to pay for the downside protection. In the instance ***the Fiduciary has fixed both a minimum and maximum value for the estate, creating the potential for gain while eliminating the risk of loss.*** Such an arrangement is consistent with the general principles of prudent management.

In the event the estate portfolio remained at the same valuation at the AVD, there obviously would be no benefit from either taxes or appreciation. But with the zero cost option collar there would neither be any harm or expense to the estate value.

The strategy is only possible if such option transactions are allowed under applicable state law and are included in the powers given to the Fiduciary under the controlling will and trust provisions. The main legal issue in this arrangement, though, is whether the purchase of the estate option collar somehow destroys the estate's ability to use the AVD. If a binding contract for the sale, exchange or other disposition of property is entered into, the property generally is considered to be sold, exchanged or otherwise disposed of on the effective date of the contract, the exception being if the contract is not subsequently carried out substantially in accordance with its terms.

The estate option collar gives "a right" to the Fiduciary to exercise the contract, but there is "no contractual obligation" to the Fiduciary to exercise the contract. There are no cases or rulings directly on point, so it seems reasonable to conclude that a disposition of a security does not occur when the estate enters into the estate option transaction.

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