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MAXIMIZING PROFITS FROM AN ESTATE SALE

By Tom Gammino, Vice President of Sales, Massey Knakal Realty Services

When it is imperative that real property from an Estate must be sold, it's no surprise that the seller's primary goal is to maximize profits. However, in today's market the reality of these 'need-to-sell' scenarios is that Estates are <u>not</u> getting the most from a sale. Too often, an Estate ends up in a situation where they pay more in taxes than they should AND realize fewer dollars from a sale than they could. How much more? In some cases millions of dollars. Although you can't avoid paying taxes, you can strategically--and legally-- minimize the potential tax burden and maximize your proceeds from a sale by understanding what influences an Estate's tax liability and knowing where to go to get this information.

In the instance of an ordinary property sale, profit is determined by the sale price less the property's tax basis. Basis is the value assigned to an asset for the purposes of determining gain (or loss), and is generally the original purchase price paid for the property plus the cost of any capital improvements. In an Estate sale, however, properties receive the unique benefit of a "stepped up" tax basis, which means, the property is valued at today's market price, or fair market value.

Treasury Regulations, Subchapter B, Sec. 20.2031-1 defines fair market value as "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts." This section further states that the value shouldn't be derived by "the sale price of the item in a market other than that in which such item is most commonly sold…taking into account the location of the item" nor should it be determined based on a "forced" sale price. In short, **the basis is to be determined by recent non-distressed comparable sales in close proximity to the subject property**. The date chosen for the property's appraisal --- **the Valuation Date ---**as you can surmise has a direct impact on an Estate's tax liability, particularly in a volatile market.

The typical valuation date for an Estate's appraisal is the date of death – a rule established by the Internal Revenue Code Sec 1014 and Treasury Regulations, Subchapter B, Sec. 20.2031-1. However, few sellers are aware that they have some flexibility here. Under the terms of Treasury

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Regulations, Subchapter B, Sec. 20.2032-1, the seller has been accorded two other alternate valuation options: 1) a valuation date six-months after the date of decedent's death or, 2) if the property is sold within 6 months, it is valued as of the date on which it was sold. It is important to note that once the election is made to opt for the alternative valuation date, it is irrevocable and must apply to all the property in the Estate uniformly.

In a flat market, choosing the valuation date for an Estate's appraisal within the six-month window makes little difference in either Estate taxes paid or sale proceeds realized. But, as referenced previously, choosing the correct valuation date in a volatile market – like today's -- needs to be a strategic choice, otherwise it could cost the Estate millions of dollars. For example, during a rising market the date of death is typically the valuation date used because it minimizes the estate taxes. (The risk associated with a sale shortly thereafter is an IRS audit of the Estate return if the sales price realized is much greater than the appraised valuation that was used as the basis for the payment of Estate taxes.) The more challenging situation is in a falling market where the reverse logic applies. The Estate should either pursue the six-month valuation option or, if necessary, sell the property within the first 6 months in order to minimize estate tax consequences and maximize proceeds from a sale.

With the understanding that the selection of the valuation date is a major strategic decision in the sale of an Estate, how can an executor ensure that he/she has chosen the most advantageous date? The answer is by bringing in a person that has insight into which way the market is moving and intimate knowledge of relevant property sales. A local market expert is the best source of this information. In most cases, the broker is knowledgeable not only of all the comparable sales in the area and the players involved, but more importantly knows the story behind each sale so that he/she can easily distinguish between a true comp and misleading market information. Furthermore, by speaking to a broker an Estate can tap into the broker's insider knowledge of where the market is headed based on transactions that are under contract and more importantly those that are currently being negotiated.

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The mistake most often made in an Estate sale is that the knowledge of the broker is underutilized. The executors bring them in to effectuate a sale only after a valuation date has been selected and an appraisal has been performed. At this point the Estate will have lost the strategic benefit of broker's expertise, especially if it turns out that the Estate would have been better off by selling the property within 6 months of the date of death. By consulting a knowledgeable broker as soon as possible after the date of death, the Estate increases the probability that they will better understand the direction of the market and will select the appropriate valuation date at NO EXTRA COST to the Estate. During probate, the question to ask is not whether you should consult a broker but why you haven't done so already. As we all know, time is money, and when you ask the right broker for their time, they will make you money.