PECUNIARY v. FRACTIONAL SHARE:
WHAT ARE THE CONSIDERATIONS?

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I. DRAFTING ALTERNATIVES – OVERVIEW

A. This outline will review the tax and planning implications for the use of a pecuniary or fractional funding formula approach to funding shares of an estate or trust, including marital shares, credit shelter shares, and other types such as generation-skipping shares.

B. Funding alternatives:

1. True worth – funding of pecuniary share utilizes date of distribution values.

2. Minimum worth – funding of pecuniary share is at lower of federal estate tax values or date of distribution values.

3. Fairly representative – funding of pecuniary share is at income tax basis and the assets selected must have aggregate FMV fairly representative of appreciation or depreciation of all assets available for distribution.

4. Fractional share –
   a) Pre-tax residue or true residue fraction.
   b) Pro rata funding allocates a fractional interest in each asset to the shares; or
   c) Pick and choose funding with date of distribution values used to determine the fraction and assets.

II. PECUNIARY FORMULA VARIATIONS – PLANNING CHECKLIST

A. See Appendix 4 for cites and references to the appropriate sections of the code and regulations.

B. True worth formula characteristics:

1. Requires a revaluation of assets for funding at date of distribution values.

2. Treated as a sale or exchange for income tax purposes, with potential for gain or loss.

3. Carries out DNI to the extent of FMV –
a) Consider effect of the new separate share rules, as set forth in Appendix 3. The result generally is to “convert” a pecuniary funding to a fractional funding as distributions and disbursements are made.

b) If statutory interest is payable, the separate share regulations take the position that the interest is non-deductible by the estate.

4. Accelerates IRD.

5. Administration is fairly straightforward, flexibility in allocating assets is limited, and the funding is relatively easy to explain to the client.

6. True worth marital share:
   a) If the estate is large, and the marital share is large, the gain on funding and acceleration of IRD problems are exacerbated.
   b) The marital share will not be reduced if values decline prior to funding. The credit shelter amount may “vanish.”
   c) The value of the marital share is frozen if assets appreciate.

7. True worth credit shelter share:
   a) The size of the marital share is not protected, and all appreciation prior to funding will pass to the marital share. Approved in Rev. Rul. 90-3, 1990-1 C.B. 174.
   b) If the marital share is larger than the credit shelter share, the impact of gain on funding, and acceleration of IRD, are minimized.

C. Fairly representative formula characteristics:

1. The adjusted income tax basis of the assets is used for funding (for assets included in the estate, the estate tax value will be used).

2. Requires a revaluation of assets at the date of distribution to determine the effect of appreciation or depreciation prior to distribution.

3. No gain or loss on funding.

4. Carries out DNI to the extent of the lesser of FMV and basis. An election under I.R.C. §642(e)(3) will increase FMV and increase the amount of DNI that is carried out.

5. Accelerates IRD.
6. Administration can be complex, and flexibility in allocating assets is limited.

7. Both the marital and credit shelter shares will participate in the rise and decline of asset values.

D. Minimum worth formula characteristics:

1. Assets are distributed at the lesser of FMV at date of distribution or adjusted income tax basis (for assets included in the estate, the estate tax value will be used).

2. No gain on funding. Loss on funding if FMV exceeds basis will be disallowed if the distribution is from trust to trust (e.g. funding a marital trust from a revocable trust), unless the election under I.R.C. §645 is effective; a distribution from an estate will permit loss. I.R.C. §§267(a) and 267(b)(5).

3. Revaluation is necessary only for assets that have declined in value.

4. Size of the marital gift:
   a) Overfunding is possible.
   b) Underfunding is possible.
   c) It is for this reason that a minimum worth credit shelter share would likely disqualify the marital deduction because of the possibility of eliminating the marital share altogether.

III. **FRACTIONAL SHARES – CHECKLIST**

A. General results:

1. Fraction is applied to assets at date of distribution; amount of each share is funded with assets using date of distribution value.
   a) The numerator of the fraction is the desired marital share; the denominator will be either the residue after the payment of deductible expenses but before the payment of taxes, or after the payment of all expenses and taxes. The result will affect the size of the marital share if appreciation or depreciation occur during the course of administration.
   b) The fraction will fluctuate during the course of administration as distributions and disbursements occur.

2. Drafting decision is whether to use pre-tax or after-tax fraction.