Playing the Hand You are Dealt - Administering the Marital Funding Formula

Administering the Taxable Estate

Oregon State Bar

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[1] Outline and PowerPoint slides posted on website http://www.dwt.com/People/PatrickJGreen under Bio and News and Publications.

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I. Introduction[2]

A. Marital funding objectives and factors.

1. Objectives – The usual objective is to maximize the after-tax amount of property passing to the surviving spouse and heirs. This tax objective should not be "the tail that wags the dog". In many large estates, especially where the decedent has adult children from a prior marriage and a current, younger spouse, maximizing the marital deduction can defer the distribution to the children for an interminable period of time and may not be wise. Conversely, using the maximum exemption amount for funding a trust that benefits the children from a prior marriage can inadvertently reduce or eliminate the marital trust for the surviving spouse. The drafter of an estate plan distribution using the marital and exemption gifts or transfers into trust must be able to answer the question that will be answered in estate administration – "Who gets what?".

2. Overview of types of marital approaches. Administering marital funding can take a number of paths, each of which will be discussed further in this outline. Here are the alternatives:

a. Nonformula.

(1) Specific bequest or devise

(2) Pecuniary bequest

(3) Fractional

(4) Outright marital with disclaimer

b. Formula. Marital funding formulas follow two main categories, pecuniary or fractional. There are five pecuniary and two fractional formulas. The nomenclature of the formulas break down as follows:

(1) Pecuniary.

(a) True worth marital

(b) Fairly representative marital

(c) Minimum worth marital

(d) True worth exemption

(e) Fairly representative exemption

(2) Fractional.

[2] The author credits Marisa Meltebeck and Thomas Hackett, Davis Wright Tremaine 2009 summer associates for their able assistance in gathering excellent reference materials.

(a) Pro rata

(b) Pick and choose

(3) Single fund marital. Another category that is neither pecuniary nor fractional involves single fund marital trust funding. These would include the following:

(a) Divisible QTIP

(b) Clayton QTIP

(c) Reverse QTIP

3. Which formulas are used the most? Studies show that most practitioners repeatedly use only a few of the choices which tend to be the ones that they understand and favor. According to one study, Moore & Pennell, "Practicing What We Preach: Esoteric or Essential?", 27 *U. Miami Inst. Est. Plan*, ¶1211 (1993) (survey of University of Miami Estate Planning Instituted registrants) most of the respondents utilized the following marital formulas:

a. Pre-residuary pecuniary true worth marital

b. Reverse true worth marital

c. Fractional pick & choose marital

d. Note however, that this study was compiled when many state inheritance taxes were not decoupled as now exists in many states, including Oregon

B. Frequently-used terms and common assumptions. For purposes of this outline, all gifts shall be deemed to be in trust rather than outright with the titles "marital" or "exemption" assigned to each trust. Note that the exemption trust is often referred to as the "bypass trust", "credit shelter trust" and sometimes as "the family trust". Frequently, the term "pre-residuary" or "residuary" is applied to the marital formula. Pre-residuary prioritizes determining the marital first on a pecuniary basis with the residuary falling into the exemption trust. Residuary marital prioritizes funding the exemption trust first on a pecuniary basis with the residuary falling into the marital. In using formulas, the estate planner has chosen to either maximize the marital deduction or the applicable exclusion equivalent (exemption amount) and to then either use a pecuniary or fractional formula. Occasionally, these formulas are referred to as "reduce to zero tax" marital formulas. Finally, funding alternatives include the following pecuniary funding alternatives: "true worth" (using date of distribution values), "fairly representative" (using final values for estate tax), "minimum worth" (the lesser of basis or fair market value at date of distribution), or the following two fractional funding formulas, "pro-rata" (of each asset's value at date of distribution) or "pick and choose" (selecting assets that fairly represents the appreciation or depreciation from date of death to date of distribution).

C. Factual Scenario to be referenced (with variations) throughout the outline.

A new client, the surviving spouse, has just arrived for their first appointment. The client presents you with the deceased spouse's will and an appraisal of the value of the decedent's property as of date of death. Your engagement will be to administer the estate, interpret the will and fund the marital, exemption and/or the disclaimer gift or trusts and advise the client on the appropriate elections. Assume that the decedent's estate was valued at date of death at $4,500,000 and that the surviving spouse's estate is of equivalent value for a total combined estate of $9,000,000.

II. The Basic Marital Approaches, Considerations and Formulas.

A. Factors to consider in using the unlimited marital deduction:

1. Equalize spouses estates

2. Health and life expectancy of respective spouses

3. Time of deferral of distribution to children during surviving spouse's lifetime

4. Potential appreciation of or return on investment of property

5. Likelihood of surviving spouse spending down or gifting property

6. Compression of estate tax rates (flat federal rate 45% absent return to pre-2002 estate tax law; Oregon Inheritance graduated rates 6.4 to 16%)

7. Estate tax law changes

B. Non-formula marital.

1. Specific bequest or devise. "I give my spouse the Lake Tahoe house".

2. Pecuniary bequest. A specific dollar amount - "I give my spouse the sum of $1,000,000".

3. Fractional. "I give my spouse 50% of the Merrill Lynch investment account or the family farm".

4. Outright Marital with Disclaimer Trust. The will may give the surviving spouse the entire decedent's estate with the option of disclaiming all or a part into a disclaimer or exemption trust. This approach may be used when the marital gift or trust would be overfunded; or to state the opposite – when the exemption portion would be underfunded. A similar approach may also be used to increase the marital portion where the property is left to the surviving child or children who can make an effective disclaimer of all or a portion of their inheritance in favor of their surviving parent to be used within the surviving parent's exempt portion if the parent lacked sufficient assets to fully use their applicable exemption equivalent. Placing the disclaimer option into the will or trust provides the estate administrator and surviving spouse with flexibility following the death of the first spouse to die to achieve some tax savings at the surviving spouse's death.

    a. Sample language:

Spouse Survives. If my spouse survives me, my Trustee shall distribute the residue of my estate to my spouse.

Possibility of Disclaimer. If Spouses First Name (or Spouse's First Name's legal representative) disclaims any portion of my estate, the disclaimed interest or portion will be held as a separate trust (the "Disclaimer Trust") under the same terms as the Exemption Trust; provided, however, that, notwithstanding any other provisions herein, Spouse's First Name shall not have a power of appointment over any assets held in the Disclaimer Trust.

b. Issues to satisfy for a qualified disclaimer.

(1) I.R.C. Sec. 2046 and 2518. Section 2046 cross references to Section 2518 for purposes of determining if the disclaimer is a "qualified disclaimer" and therefore the property disclaimed is not treated as property ever received by the disclaimant.

(2) Issues under Section 2518. For a disclaimer to be a "qualified disclaimer", it must satisfy all of the following requirements

(a) In writing,[3]

(b) Received by the legal representative of the transferor of the interest,[4]

(c) Not later than 9 months after the day on which the transfer creating the interest was made,[5]

(d) The recipient has not accepted the interest or any of its benefits,[6]

(e) The interest passes without any direction on the part of the disclaimant,[7]

(f) And passes either to the spouse of the decedent,[8]

(g) Or, passes to a person other than the disclaimant.[9]

(h) And where the disclaimant holds no power with respect to the disclaimed property (treated as an interest in the property disclaimed).[10]

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[3] I.R.C. Sec. 2518(b)(1).
[4] I.R.C. Sec. 2518(b)(2).
[5] Ibid.
[6] I.R.C. Sec. 2518(b)(3).
[7] I.R.C. Sec. 2518(b)(4).
[8] I.R.C. Sec. 2518(b)(4)(A).
[9] I.R.C. Sec. 2518(b)(4)(B).
[10] I.R.C. Sec. 2518(c)(2) and Regs. Sec. 25.2518-2(e)(5), Ex. 5.

c. The use of a disclaimer trust stripped of powers and flexibility that might appear in an exemption trust may be safer. However, the disclaimed portion may fall into the exemption trust provided that the trust for purposes of the disclaimed portion avoids a special power of appointment for the disclaimant and avoids sprinkling powers (without an ascertainable standard for distribution) in the discretion of the trustee if the surviving spouse is serving as trustee.

5. These approaches are deceptively simple as funding the gift or trust can trigger unexpected tax or administrative outcomes. The issues, which will be discussed later in this outline, include the following:

a. Source of tax payment

b. Administrative expenses charged to principal

c. Recognition of gain or loss on funding a pecuniary amount with an equivalent amount of appreciated property

d. DNI – "distributable net income" (non-specific bequest)

e. IRD – "income in respect of a decedent" in satisfaction of a pecuniary bequest

f. Basis

g. Triggering losses – related party limitations

h. Unused losses or excess deductions of the estate

i. Generation skipping transfer tax (GST)

C. Pecuniary Marital. This formula is often referred to as a "pre-residuary" marital formula and is appropriately used where the portion for the marital trust is small compared to the amount for the exemption trust. The following language provides a pecuniary marital formula for funding the marital and exemption trusts:

1. Sample language:

Division of Estate If my spouse survives me, the residue of my estate shall be divided into two shares, referred to as the "Marital Trust/Gift" and the "Exemption Trust."

Transfers to Marital Trust/Gift. The Marital Trust/Gift shall consist of the smallest pecuniary amount of my estate needed to qualify for the federal estate tax marital deduction to result in the least possible federal estate tax payable in respect of my estate less the sum of other items passing to or for the benefit of [my Spouse's First Name] other than by the terms of this paragraph that also qualify for the federal estate tax marital deduction.

Transfers to Exemption Trust. The Exemption Trust shall consist of the value of my residuary estate.

Valuation of Assets. For purposes of the division of my estate pursuant to this paragraph, values of all assets shall be those finally determined for federal estate tax purposes.

2. Issues. Note that the formula is determined by valuing the assets under final values for federal estate tax purposes which may mean date of death values or values under alternative valuation authority.[11]

D. Residual Marital (Pecuniary Exemption). This formula is frequently referred to as a "front-end credit shelter" or "credit consuming" trust. The following language provides a residual marital formula for funding the marital and exemption trusts:

1. Sample language:

Division of Estate If my spouse survives me, the balance of my estate shall be divided into two parts, referred to as the "Marital Trust/Gift" and the "Exemption Trust."

Allocation to Exemption Trust. The Exemption Trust shall consist of the largest pecuniary amount of my estate needed to result in the least possible federal estate tax payable in respect of my estate. My Trustee shall take into account all assets that are includible in my gross estate passing under this Will or otherwise and that do not qualify for the marital or charitable deduction.

Allocation to Marital Trust/Gift. The Marital Trust/Gift shall consist of the value of my residuary estate.

Valuation of Assets. For purposes of the division of my estate pursuant to this paragraph, values of all assets shall be those finally determined for federal estate tax purposes.

2. Issues. Note that the formula is determined by valuing the assets under final values for federal estate tax purposes which may mean date of death values, values as adjusted under audit or values under the alternative valuation authority (on the later only if the estate generated taxes and both the value of the gross estate and estate taxes were reduced).[12]

E. Fractional Marital. The following language provides a fractional marital funding approach:

1. Sample language: Spouse Survives. If my spouse survives me, my Trustee shall divide the balance of my estate into two parts, referred to as the "Marital Trust" *[called "Marital Gift" if it goes outright to spouse]* and the "Exemption Trust."

Allocation to Marital Trust/Creation of the Marital Gift. The Marital Trust/Gift shall consist of the fractional share of my estate needed to qualify for the federal estate tax marital deduction to result in the least possible federal estate tax payable in respect of my estate ("the Fraction") calculated as follows:

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[11] I.R.C. Sec. 2031 and 2032.
[12] I.R.C. Sec. 2031 and 2032.

The numerator of the Fraction shall be the smallest amount that, if allowed as a federal estate tax marital deduction, would eliminate or reduce to the lowest possible amount the federal estate tax liability of my estate. This amount shall be calculated by taking into account my applicable exclusion amount (as defined in the Code), all amounts passing to or for the benefit of [my Spouse's First Name] other than by the terms of this paragraph that also qualify for the federal estate tax marital deduction, and all other credits or deductions, but only to the extent that state death taxes are not thereby increased.

The denominator of the Fraction shall be the value of my residuary estate.

Allocation to Exemption Trust. The Exemption Trust shall consist of that portion of my estate not included in the Marital Trust.

Valuation of Assets. For purposes of the division of my estate pursuant to this paragraph, values of all assets shall be those finally determined for federal estate tax purposes.

2. Issues. Note that the formula is determined by valuing the assets under final values for federal estate tax purposes which may mean date of death values, values as adjusted under audit or values under the alternative valuation authority (on the later only if the estate generated taxes and both the value of the gross estate and estate taxes were reduced).[13] Note that the Code does not provide specific language for the fraction. Nevertheless, one can find several different approaches to defining the denominator. Some of these approaches are problematic – as in "The denominator of the Fraction shall be the value of my residuary estate for federal estate tax purposes". This term is not required to be calculated for federal estate tax purposes. Also, the determination of the denominator is made on the value of the residuary estate in an accounting sense. For example, where the payment of administrative expenses charged to principal but claimed as income tax rather than estate tax deductions, the denominator must reflect the reduced value of the estate after actual payment of these amounts or the marital portion will be overstated. The residuary estate denominator will be reduced regardless of whether or not these expenses are claimed as income or estate tax deductions.[14]

F. Single Fund Marital. Another category that is neither pecuniary nor fractional involves single fund marital trust funding. These would include the following:

1. Divisible QTIP. Where the entire estate benefits the surviving spouse, the governing document could allocate all to a single fund QTIP and authorize the trustee to divide the QTIP trust to maximize the exemption, GST and marital benefits. The regulations authorize the use of a formula, either percentage or fractional, which will reflect the proportional increase or decrease in value of assets on funding.[15] Unlike the decision on a disclaimer that must be made within nine months of death, the trustee has up to fifteen months to elect the appropriate portion for the QTIP.

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[13] I.R.C. Sec. 2031 and 2032.

[14] See Covey, Richard B., "Marital Deduction and Credit Shelter Dispositions and the Use of Formula Provisions, United States Trust Company of New York (1984 as supplemented periodically).

[15] Regs. §20.2056(b)-7(b)(2)(i).

2. Clayton QTIP. Here the estate passes to the QTIP only to the extent that the personal representative or trustee elects. The non-elected portion is held in an exemption trust. The exemption trust may contain sprinkling provisions for beneficiaries other than the surviving spouse. Therefore, the fiduciary may shift beneficial interests in this election. In Oregon, the Special Marital Property Election may also be made as to a portion of the exemption trust to qualify the elected portion for deferral of the Oregon Inheritance Tax until the death of the surviving spouse. See *Clayton v. Commissioner*[16].

3. Reverse QTIP. In an estate where the GST exemption may not be equal to the applicable exclusion (as in situations where the applicable exclusion may have been used on non-GST transfers during lifetime, where the GST exemption had been applied to annual exclusion gifts or where non-GST bequests may be made at death) a reverse QTIP election may be made to qualify the portion of the marital trust over which a reverse QTIP election has been made for GST exemption purposes. The GST exemption may be assigned to that portion thus increasing the exempt amount.

4. Sample language. The following language provides a single fund marital formula for funding the marital and exemption trusts. This version utilizes the approach sanctioned in *Clayton v. Commissioner*[17] and includes the Oregon Special Marital Property funding election option[18] as well. The previous versions would also include the Oregon Special Marital Property Election language as well although that provision would be found in the body of the Exemption Trust. This approach is frequently referred to as a "QTIP all", Clayton or "Cascading Clayton":

Division of Estate. If my spouse survives me, the balance of my estate shall be administered pursuant to Paragraph 7 (the "Marital Trust"); provided, however, that any portion of my estate for which a marital deduction election for federal estate tax purposes is not made pursuant to Section 2056(b)(7) of the Code, if any, shall be set aside in a separate trust (the "Oregon Special Marital Property Trust") and shall be applied as provided in Paragraph 8; further provided, however, that any portion of the Oregon Special Marital Property Trust for which an Oregon special marital property election for Oregon inheritance tax purposes is not made pursuant to ORS 118.013-118.016 shall be set aside in a separate trust (the "Exemption Trust") and shall be applied as provided in Paragraph 9.

For purposes of the division of my estate pursuant to this Paragraph, values assigned to all assets shall be those finally determined for federal estate tax purposes.

5. Issues. Note that the formula is determined by valuing the assets under final values for federal estate tax purposes which may mean date of death values, values as adjusted under audit or values under the alternative valuation authority (on the later only if the estate generated taxes and both the value of the gross estate and estate taxes were reduced).[19]

III. Basic Allocations/Distributions. Upon calculating the respective fraction or pecuniary amounts of the marital and exemption trusts and after payment of expenses of

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[16] 976 F. 2d 1486 (5th Cir. 1992), rev'g 97 TC 327 (1991); Reg. § 20.2056(b)-7(d)(3) and Reg. § 20.2056(d)(3).
[17] 976 F. 2d 1486 (5th Cir. 1992), rev'g 97 TC 327 (1991); Reg. § 20.2056(b)-7(d)(3).
[18] ORS 118. 118.013-118.016.
[19] I.R.C. Sec. 2031 and 2032.

administration and taxes, the trusts must eventually be funded with assets from the estate. This task is governed by particular approaches associated with the specific marital formula.

A. Pecuniary Marital – There are three basic approaches that are guided by the principals in Rev. Proc. 64-19, 1964-1 C.B. 682. The revenue procedure contains specific funding limitations that apply to funding pecuniary bequests, whether by pre-residual marital or reverse marital formulas. The limitations prevent the funding of the marital portion with assets valued at estate tax values which have depreciated and funding the exemption portion with assets that have appreciated since the date of death, a strategy which would additionally leverage the tax advantages offered by the formulas. The ruling allows a marital deduction where state law or the governing instrument requires the fiduciary that is funding the pecuniary marital portion to distribute assets observing one of the following alternatives:

1. True Worth. This formula funds the marital portion using a "true worth" or date of distribution value approach. The marital trust is funded with assets equal to the value of the marital deduction which had been established using date of death values. This formula freezes the amount of the marital trust while passing on increases or decreases in the value of assets that occur during the term of estate administration to the exempt trust. Gain or loss may occur on funding the pecuniary marital trust although no gain or loss occurs on funding the Exempt Trust. A sample clause follows:

<u>Asset Allocation</u>. My Trustee shall have unrestricted discretion to determine which assets shall be allocated to the Marital Trust and the Exemption Trust; provided, however, that my Trustee shall first allocate to the Exemption Trust, any asset with respect to which a marital deduction for federal estate tax purposes is not allowable due to its character or restrictions associated with it; and the assets allocated to each Trust shall be valued at their respective fair market values on the date or dates of each allocation.

2. Fairly Representative (of the appreciation/depreciation of the asset values on funding). The value of assets in the marital trust must reflect the proportionate change in value of assets in the estate under the governing instrument. This is accomplished by allocating assets valued at the estate tax value to the marital portion. The fiduciary could fund the marital share with a fraction of each asset representing the marital share's prorata portion of each asset. If, for example, the marital share was $1,000,000 out of a $4,500,000 estate, the fiduciary could fund the marital with a portion of each asset equal to the value of the asset at the date of funding multiplied by a fraction equal to 1 over 4.5. Thus the portion of an appreciated asset with a basis of $200,000 but a value at time of funding equal to $250,000 allocated to the marital portion would be determined to be $55,556 ($250,000 X 1 over 4.5). As an alternative, the fiduciary might fund the marital share using a two-pronged approach: the assets allocated to the marital must meet both of the following criteria:

a. The aggregate basis of assets distributed to the marital trust must equal the amount of the marital deduction in the estate (usually this basis is the value of the asset as finally determined by estate tax values since the basis gets stepped up at date of death under I.R.C. Sec. 1014), and

b. The aggregate fair market value of the assets distributed must, at the date of distribution, approximately equal the marital trust's pro rata portion of assets available in the estate.

The will or trust should contain language sufficient to allow the personal representative or trustee to choose from one of the following alternative methods of funding to provide the most flexibility. A sample clause follows:

Asset Allocation. My Trustee shall have unrestricted discretion to determine which assets shall be allocated to the Marital Trust and the Exemption Trust; provided, however, that:

My Trustee shall first allocate to the Exemption Trust, any asset with respect to which a marital deduction for federal estate tax purposes is not allowable due to its character or restrictions associated with it; and

the assets allocated to each Trust shall be fairly representative of the proportional share of the appreciation or depreciation in value, to the date or dates or distribution, of all property when available for distribution. My Trustee may either distribute a fractional share of each asset to the Marital Trust as a prorata distribution, or distribute assets having an aggregate basis equal to the amount of the marital deduction in the estate and where the aggregate fair market value of the assets distributed must, at the date of distribution, approximately equal the marital trust's pro rata portion of assets available in the estate.

3. Minimum Worth. The value of the assets in the marital trust must be equal to the amount of the lesser of 1) the value of assets with an aggregate income tax basis for federal income tax purposes or 2) the fair market value of assets as of the date of distribution. The governing instrument must proscribe this language. The fair market value of assets is relevant only if it is less than the tax basis. A sample clause follows:

Asset Allocation. My Trustee shall have unrestricted discretion to determine which assets shall be allocated to the Marital Trust and the Exemption Trust; provided, however, that

my Trustee shall first allocate to the Exemption Trust, any asset with respect to which a marital deduction for federal estate tax purposes is not allowable due to its character or restrictions associated with it; and

the value of the Marital Trust shall be equal to an amount that is the lesser of 1) the value of assets with an aggregate income tax basis for federal income tax purposes equal to the value of the Marital Trust or 2) the fair market value of assets as of the date of distribution of no less than the amount of the Marital Trust as finally determined for federal estate tax purposes.

4. Rev. Proc. 64-19 specifically does not apply to:

a. a bequest or transfer in trust of a fractional share of the estate where each beneficiary shares proportionately in the appreciation or depreciation in the values of assets to the date or dates of distribution;

b. a bequest or transfer in trust of specific assets; and

c. a pecuniary bequest or transfer in trust whether in a stated amount or an amount computed by the use of a formula, if 1) the fiduciary must satisfy the bequest or transfer in trust in cash, 2) the fiduciary has no discretion in the selection of the assets to be distributed in kind, or 3) the assets to be distributed in kind to satisfy the bequest or transfer in trust must be valued at the date or dates of distribution.

d. Note that under paragraph 4.b) above, a distribution of the Lake Tahoe residence to my spouse in an outright marital gift or transfer into trust would not trigger gain on funding.

B. Residual Marital – Two of the above three approaches are utilized in funding the reverse marital trust (also referred to as the "upfront credit shelter trust" or "reverse marital"):

1. True Worth – sample clause:

Asset Allocation. My Trustee shall have unrestricted discretion to determine which assets shall be allocated to the Marital Trust and the Exemption Trust; provided, however, that

My Trustee shall first allocate to the Exemption Trust, any asset with respect to which a marital deduction for federal estate tax purposes is not allowable due to its character or restrictions associated with it; and

the assets allocated to each Trust shall be valued at their respective fair market values on the date or dates of each allocation.

2. Fairly Representative – sample clause:

Asset Allocation. My Trustee shall have unrestricted discretion to determine which assets shall be allocated to the Marital Trust and the Exemption Trust; provided, however, that

My Trustee shall first allocate to the Exemption Trust, any asset with respect to which a marital deduction for federal estate tax purposes is not allowable due to its character or restrictions associated with it; and

the assets allocated to each Trust shall be fairly representative of the proportional share of the appreciation or depreciation in value, to the date or dates or distribution, of all property when available for distribution.

3. Note that the minimum worth approach should not be used in the reverse marital approach.

C. Fractional Pro-Rata. The fraction is applied to each asset each time that an asset is distributed to the trusts until all available assets have been distributed. A fractional share of each asset is distributed to the Marital and Exempt Gift/Trust proportionately. Revaluation of assets is not required. Non pro rata distributions create challenges since the fraction must change for future distributions and the exchange of assets may trigger gain or loss on the exchanged assets.[20] A sample clause follows:

Asset Allocation. My Trustee shall apply the Fraction calculated in this paragraph to each asset valued at the date of distribution to the Marital Trust and the Exemption Trust; provided, however, that my Trustee shall first allocate to the Exemption Trust, any asset with respect to which a marital deduction for federal estate tax purposes is not allowable due to its character or restrictions associated with it and a fractional share in each remaining asset shall be allocated to both the Marital Trust and the Exemption Trust.

2. Pick & Choose. Funding under this method uses the same approach as in the fractional pro rata approach above except that the governing instrument permits the Personal Representative or Trustee, after applying the fraction to each asset to be distributed to the Marital and Exempt Gift/Trusts, to allocate and distribute, in whole or in part of each asset, non pro rata, to either or both the Marital and Exempt Gift/Trusts. The non pro rata funding of the Marital and Exempt Gift/Trusts may create tax recognition. Property used to fund is valued at its date of distribution values. A sample clause follows:

Asset Allocation. My Trustee shall apply the Fraction as determined in this Paragraph above to available assets within my estate, revalued at date of distribution to the Marital and Exemption Trusts, to determine a dollar value for each trust. My Trustee shall then distribute assets to the Marital Trust and the Exemption Trust, using such date of distribution values of the selected assets for each trust until the full dollar value of each trust has been satisfied; provided, however, that

my Trustee shall first allocate and distribute to the Exemption Trust, to the extent such assets represent a part of my estate, any asset with respect to which a marital deduction for federal estate tax purposes is not allowable due to its character or restrictions associated with it;

my Trustee may allocate and distribute, in whole or in part of each remaining asset, non pro rata, to either or both the Marital Trust and the Exemption Trust;

my Trustee shall apply the Fraction to the available property of my estate to determine the dollar amount of the Marital Trust for each successive partial distribution of assets for funding the Marital Trust; and

my Trustee shall use the fair market value of assets in successive distributions as of the date of distribution.

IV. Selected Administrative and Tax Issues

A. Changing Asset Values During Period of Administration

1. The problem: Because funding of the marital and exemption trusts on the decedent's actual date of death would be nearly administratively impossible, the values of assets in the estate at a later funding date will not likely be the same value as the date of death values. Asset values will experience increases or decreases

[20] Rev. Rul. 69-486, 1969-2 C. B. 159.

during the term of the administration. Funding under the various marital formulas can yield surprising results if one is unaware of the potential outcomes. The following facts illustrate the outcomes using the various marital formulas.

2. Facts. In our factual scenario, assume that the assets in the decedent's estate are valued at $4,500,000 at date of death. Further assume that the will contains one of the following three marital funding formulas - a pecuniary marital (true worth funding), reverse marital (true worth funding) or fractional formula. What is the outcome where the values of the assets at date of funding reflect one of three possibilities: (1) a static value? (2) appreciation of $500,000, or (3) declining value of $500,000?

SEE NEXT PAGE FOR CHART

True Worth Marital			
	Marital	exemption	
static	1,000,000	3,500,000	
appreciation (up 500k)	1,000,000	4,000,000	
depreciation (down 500k)	1,000,000	3,000,000	
True Worth Reverse Marital			
static	1,000,000	3,500,000	
appreciation (up 500k)	1,500,000	3,500,000	
depreciation (down 500k)	500,000	3,500,000	
Fractional			
static	1,000,000	3,500,000	
appreciation (up 500k)	1,111,111	3,888,889	
depreciation (down 500k)	888,889	3,111,111	

3. Observations.

a. If the objective is to freeze the marital trust and capture valuation increases in the exemption trust, how do the following formulas perform?

(1) Fractional – ineffective as both trust portions rise or fall with the changes in value.

(2) Pecuniary marital – effective as the dollar amount of the marital trust is funded with the exact value of assets needed to equal that dollar amount. The exemption trust captures the increased value.

(3) Reverse marital (pecuniary exemption) – ineffective as the dollar amount of the exemption trust is funded with the exact value of assets needed to equal that dollar amount. The marital trust captures the increased value.

b. Note, however, that in answering the basic question, "Who gets what?" the outcomes differ substantially if the recipient of the benefits of the exemption trust is other than the surviving spouse. These outcomes may aggravate existing tensions or initiate conflict among the various classes of beneficiaries.

B. Source of Tax Payment.

1. Apportionment v. Residue. The governing instrument or state law will designate the source of payment of estate and inheritance taxes. Unless the will provides otherwise, the default under Oregon law provides for apportionment of estate (and inheritance) taxes under ORS. 116.303 – 116.383. Under this statute, the tax is apportioned among those persons who are interested in the estate in the proportion that their interest bears to the total value of all of the interests of persons interested in the estate. Notwithstanding this general apportionment outcome, the interests passing to surviving spouses or charities to the extent that they are deductible interests do not figure in the computation and those interests do not bear a share of the taxes.[21] If the will, however, provides that the taxes are chargeable to the residue of the estate without apportionment, the amount of the marital gift or trust may be reduced[22] resulting in the imposition of estate and inheritance taxes or resulting in the reduction of the exemption trust.

2. Illustration. This problem can be illustrated by the following example:

Decedent's will contains a fractional residuary bequest to divide her residuary $10,000,000 estate equally between her children from a previous marriage and her surviving spouse. She assumes that each will receive $5,000,000. However, her will charges the residue with tax without apportionment. One would assume that the $5,000,000 to the surviving spouse would qualify for the marital deduction but would expect only $3,500,000 would be tax-free (due to the applicable exclusion in 2009) to her children, resulting in a taxable estate of $1,500,000 and a $675,000 tax assuming a 45% rate. However, because the residue will be charged with tax, the marital portion will be reduced resulting in interrelated calculations which reduces the marital and increases the tax due. The IRS Publication 904, Interrelated Computations for Estate and Gift Taxes provides guidance for these calculations.[23] This result could have been avoided if she would had either apportioned the tax or used a "reduce to zero" formula. If the apportionment approach had been used, the surviving spouse would receive $5,000,000 and the children $4,325,000 ($5,000,000 – 675,000). The use of a reverse pecuniary marital formula ("reduce to zero") would have resulted in the children receiving $3,500,000 and the surviving spouse with $6,500,000 without the imposition of estate tax. The $6,500,000 could have been placed into a QTIP trust which would pass to the children at her husband's death.

[2121] ORS 116.343(5).

[22] I.R.C. §2056(b)(4)(A).

[23] Now out of print. Software available or call IRS.

C. Principal and Income Act.. Oregon's Uniform Principal and Income Act provides guidance to fiduciaries in administering estates or trusts.[24] Personal representatives of estates or trustees of trusts with terminating income interests that pay fees of attorneys, accountants and fiduciaries as well as court costs, other expenses of administration and interest on death taxes from income of property passing to a trust for which the fiduciary claims a marital deduction may do so only if the payment of those expenses from income will not result in the reduction or loss of the marital deduction.[25] Fiduciaries that make elections regarding tax matters that shift benefits between income beneficiaries and remainder beneficiaries must make certain adjustments between principal and income because of the tax impact.[26] If, for example, an estate tax marital deduction is reduced when a fiduciary deducts and amount paid from principal for income tax purposes rather than deducting the amount for estate tax purposes and that decision results in an increase in estate taxes paid from principal and a decrease in income taxes paid by the estate, trust or beneficiary, the estate, trust or beneficiary benefitting must reimburse the principal fund from which the increase in estate tax is paid. The reimbursement must equal the increase in the estate tax in the amount that the principal paid would have qualified for a marital deduction but for the payment.[27]

D. "Hubert" Regulations.

1. Impact of decision to deduct expense for estate or fiduciary income tax purposes. The decision to pay expenses of administration and where those expenses are charged (either to principal or income) can impact the amount of estate and inheritance taxes due. Expenses of administration of an estate may be deducted under I.R.C. 2053 in determining the taxable estate for estate tax purposes.

Examples of administrative expenses include personal representative, attorney and appraisal fees. Alternatively, these items may be deductible for determining the taxable income of the estate.[28] The election to deduct these expenses on the income tax return is often made where a decedent's estate passes under a "reduce to zero" marital formula clauses so as to not waste the deduction where no estate tax would be due and the estate could use the deduction for income tax purposes. The election allows a deduction on either return but not on both.[29] The election is accomplished with filing a waiver with the fiduciary income tax return to waive taking the deduction on the estate tax return.[30] However, if the expense is deducted for income tax purposes and charged to principal, these expenses can impact the amount of the marital share and the calculation of the marital deduction. If the expenses are paid from income, the expense can be deducted from income and the marital share is unaffected. That outcome occurs because the amount of the applicable exclusion is still fully available for estate tax purposes. However, when the expense is charged to principal, however, the amount available for the applicable

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[24] ORS 129.200-129.450.
[25] ORS 129.250(2)(b).
[26] ORS 129.425.
[27] ORS 125.425(2).
[28] Usually under I.R.C. §212.
[29] I.R.C. §642(g).
[30] See instructions to Form 1041 Fiduciary Income Tax Return

exclusion decision is reduced which can increase the amount of estate and inheritance taxes.[31]

2. Regulations. The above administrative problem arises in the context of deductions for administrative expenses permitted to the estate for determining the estate tax or for determining the fiduciary income tax of the estate and how they impact the calculation of the marital portion. In Commissioner v. Hubert Est., 520 US 93, 117 S Ct 1124, 137 L Ed2d 235 (1997), the Supreme Court agreed that the Hubert estate was not required to reduce the marital portion for the surviving spouse for estate tax purposes by the amount of administrative expenses payable out of estate income from property passing to the surviving spouse.

Reg. §20.2056(b)-4(d), passed in response to the Hubert case, effective for estates of decedents dying on or after December 3, 1999, addresses the interrelationship of administrative expenses that would qualify for an estate tax deduction under I.R.C. §2053 with the calculation of the marital deduction under I.R.C. §2056. That regulation classifies administration expenses as either *management* or *transmission* expenses. Management expenses include expenses incurred by an estate for investment of estate assets or for preservation or maintenance of assets during estate administration.[32] Examples include investment advisory fees, stock brokerage commissions, custodial fees and interest. Transmission expenses are expenses that would not have been incurred but for the decedent′s death and are necessary to collecting assets, payment of debts and death taxes and distributing property from the estate. If it is not a management expense, it is a transmission expense. Examples of transmission expenses include personal representative and attorney fees, probate fees, defending will contests and appraisal fees.[33]

For purposes of determining the marital deduction, the amount of transmission expenses paid from the marital share reduces the marital share while the amount of management expenses attributable to and paid from the marital share do not reduce the marital deduction except to the extent that they are deducted under I.R.C. §2053 on the decedent′s estate tax return.[34] Another way of stating this is that management expenses do not reduce the marital share if they are instead deducted on the fiduciary income tax return for the estate even if charged to principal of the marital portion.

3. Transmission expenses applied to a simple estate administration. The usual one-time type of administration expense involved in simple estate administrations reduce the marital deduction to the extent those expenses are paid from that portion of the estate that pass to the surviving spouse. Usually expenses of administration are paid from the estate residue. The regulation contemplates a residuary marital bequest. Whether the source of payment of estate transmission expense is estate income or principal is irrelevant; transmission expenses that reduce the estate available for the spouse reduce the deduction, regardless of whether income or principal is the source from which they are paid. Of course, the drafter of the governing instrument can direct that these expenses be paid from a

[31] I.R.C. §2056(b)(4)(A).
[32] Regs. §20.2056(b)-4(d)(1)(i).
[33] Regs. §20.2056(b)-4(d)(1)(ii).
[34] Regs. §20.2056(b)-4(d)(2) and (3).

source other than the funds passing to the surviving spouse such as from the exemption portion.

E. Recognition of gain or loss on funding with an equivalent amount of appreciated or depreciated property

1. Triggering gain. Satisfaction of a pecuniary bequest with an in-kind funding of appreciated assets will be treated as a sale and exchange resulting in the recognition of gain. Essentially, the transaction is deemed to be a sale of the asset for cash in exchange for the release of an obligation to pay a specific amount. Gain is recognized to the estate or administrative trust to the extent that the value at the date of funding exceeds the income tax basis of the asset distributed to the pecuniary share. This is true whether or not the pecuniary share is the marital or the exemption amount. Since the basis of the appreciated asset equals the value determined under I.R.C. Sec. 1014 (date of death or alternative valuation date value), the appreciation may not be significant unless unusual factors contributed to the change in value or a long period of administration has given the asset time to appreciate. The character of the gain is capital gain if the asset is a capital asset.[35] The capital gain is treated as long-term regardless of the holding period.[36] The distributee of the pecuniary bequest receives a basis equal to the fair market value of the asset at the date of distribution.[37] Note that this result can occur even when satisfying an <u>outright</u> pecuniary marital bequest with an appreciated asset. An exception to this result would be where a <u>specific asset</u> is required to be distributed to the spouse, for example, "I give my Lake Tahoe vacation residence to my spouse".[38] Note also that funding the residuary portion, whether marital or exemption, does not trigger gain or loss because no asset is being distributed in exchange for the satisfaction of a fixed obligation defined in dollar terms.

A good rule of thumb to follow in drafting to follow is to determine the relative size of the marital and exemption portion of the estate and to make the pecuniary portion the smallest of the two. For example, if the estate value was $4,500,000 and the exemption portion would equal $3,500,000 and the marital $1,000,000, the strategy would be to establish a pre-residuary pecuniary marital formula in the will or trust to minimize the potential for triggering gain (or loss, see below) on the funding. Conversely, if the estate value was $20,000,000, the pecuniary formula applied to the exempt portion would minimize exposure to income tax consequences on funding. Alternatively, the use of a fractional formula would eliminate the potential for triggering gain (or loss)[39] unless each asset is not fractionalized based upon the fraction established upon the final values established for estate tax purposes. There may be potential gain with a "pick and choose" fractional funding formula unless the governing instrument or state law permits the fiduciary to make non-pro-rata distributions.[40] Early funding of a pecuniary formula during the course of an estate or trust administration may limit the gain recognition. This could be accomplished by

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[35] I.R.C. Sec. 1223(9).
[36] Ibid.
[37] Regs. §1.1014-4(a)(3).
[38] Rev. Proc. 64-19, 1964-1 C.B. 682 (section 4.01(2)).
[39] Regs. §1.1014-4(a)(3) "amount" versus "fraction".
[40] Regs. §§1.661(a)-2(f), 1.1014-4(a)(3); Rev. Rul. 69-486, 1969-2 C.B. 159. PLR 9422052 treated the non-pro-rata funding of the survivor's, marital and exempt trusts as a non-taxable event because the trust authorized the trustee to fund using a non-pro-rata approach.

filing a petition for partial distribution in an estate probate or by distributing assets from the administrative trust in a trust administration.

2. Triggering losses – related party limitations. If at the time of funding the asset has decreased in value from its basis established under I.R.C. §1014, loss may not be recognized upon funding if the related party limitations under I.R.C. §267 apply. Those limitations apply to the situation where an administrative trust distributes depreciated property to a beneficiary (outright or in trust) in satisfaction of the obligation to fund a particular dollar amount although this limitation does not apply where a personal representative of an estate distributes to a beneficiary of the estate in the case of a sale or exchange in satisfaction of a pecuniary bequest.[41] Therefore, an estate can recognize the loss where a revocable trust cannot. An election under I.R.C. §645 to treat a revocable trust as a part of an estate presumably would bring the trust within the estate rule. If gain were to be recognized on distributions for funding, recognizing a loss simultaneously on loss assets may offset all or a part of the gain to minimize income tax consequences.

F. IRD – "income in respect of a decedent." Certain items of income received by an individual, estate or trust from the decedent are treated as "income in respect of a decedent" ("IRD").[42] Examples of these items include installment obligations, qualified retirement accounts, IRAs, deferred annuities, Series EE and HH bonds and contracts for sales of assets substantially completed before the decedent's date of death. Distributions of IRD to a decedent's estate, to the person entitled to the IRD from the decedent's estate or to the person receiving the IRD by bequest, devise or inheritance from the decedent pays income tax on the proceeds of IRD as the payment are made.[43] However, the distribution of an item of IRD in satisfaction of a pecuniary bequest accelerates the recognition of income tax on the IRD regardless of the funding method used (true worth, fairly representative or minimum worth).[44] This is so because the satisfaction of the pecuniary bequest is treated as a sale of the item of IRD.[45] Delaying the administration of the estate so that funding the bequest is deferred may be an option although the Internal Revenue Service may protest an unreasonable delay in administration for this reason. If the estate planner contemplates that an item of IRD may be in the client's estate at death, two drafting options might present themselves for inclusion in the governing document: use either a 1) specific or residuary bequest of the item of IRD which is exempt from accelerating income recognition[46] or 2) a fractional formula. Also worth noting, the recipient is allowed a deduction under I.R.C. 691(c) for the amount of the estate tax attributable to the item of IRD which alleviates some of the harsh treatment from applying two levels of taxation to the item.

G. DNI – "distributable net income" (non-specific bequest) and impact on basis. Distributions in satisfaction of a pecuniary bequest (outright or in trust) may be treated as carrying out "distributable net income" as determined under I.R.C. §643. The distributee, whether an individual or trust will include items of DNI in gross income equal to the amount of DNI whether or not the property received is cash or property.[47] This funding is not

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[41] I.R.C. §267(b)(6).
[42] I.R.C. §691.
[43] I.R.C. §691(a)(1).
[44] I.R.C. §691(a)(2).
[45] Ibid.
[46] I.R.C. §691(a)(1)(C).
[47] I.R.C. §661(a)(2).

considered to fall within the exceptions contained in I.R.C. §663(a)(1) as a bequest of a specific sum of money or of property (unless, of course, the marital distribution is actually a specific sum of money or of property). Similarly, a distribution in satisfaction of a fractional or percentage funding formula carries out DNI and likewise fails to fall within the exception although funding the fractional formula on a pro-rata basis will not generate gain or loss recognition. It does not matter whether the transfer is made to a marital or exemption gift or trust. If the distribution is in the form of property, not cash, the amount of DNI is limited to the lessor of a) the tax basis of the property in the hands of the distributee or b) the fair market value of the property.[48] The distributee's basis equals the basis to the estate or trust, adjusted for any gain or loss recognized by the estate or trust on the distribution.[49] The personal representative may elect under I.R.C. §643(e) to have the distribution carry out DNI so that the trust will recognize income equal to the basis in the property plus or minus the gain or loss recognized and the amount treated as the distribution will equal the fair market value of the property.[50]

H. Basis. The basis of distributed property in satisfaction of a marital formula depends upon the type of formula. A fractional formula using the pro-rata or non-pro-rata funding with authorization for the later funding in the governing instrument will generate no gain or loss on distribution in funding. Therefore, the recipient beneficiary or trust will receive a carry-over basis from the distributing estate or trust. An election can be made to recognize gain, however, which will increase the amount of DNI and be carried out in the distribution.[51] On the other hand, the basis of distributed property in satisfaction of a pecuniary formula (whether marital or exemption) will be the fair market value of the asset at the date of distribution to the extent that the value is included in the recipient's gross income. That is, the recipient picks up the basis in the hands of the distributor, adjusted for gain or loss recognized to the estate or trust on distribution.[52] This basis will be the lower of the basis or fair market value of the property distributed.[53] Of course, if the election to carry out DNI is made, the basis will be the fair market value of the property distributed.

1. Example – funding a pre-residuary pecuniary marital under a true worth formula. If, upon funding a $1,000,000 marital bequest and a residual exemption trust, the funding of both trusts was accomplished with appreciated assets, DNI would flow to the marital trust to the extent of fair market value of the assets funding such portion but the DNI to the residuary exemption trust would be equal to the lesser of the basis or the fair market value of the property distributed absent a I.R.C. §643(e)(3) election.

2. K-1s. Schedule K-1 will need to be prepared for reporting DNI distributions to the marital or exemption trust distributions when filing Form 1041 Fiduciary Income Tax Return whether or not the funding is under a pecuniary or fractional formula for both the marital and exemption trusts.

I. Unused losses or excess deductions of the estate. The unused losses or excess deductions of an estate can pass through to the beneficiary of an estate or trust

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[48] I.R.C. §643(e)(2).
[49] I.R.C. §643(e)(1).
[50] I.R.C. §643(e)(3).
[51] I.R.C. §643(e)(3).
[52] I.R.C. §643(e)(1) and Regs. §1.661(a)-(2)(f).
[53] I.R.C. §643.

when the estate or trust terminates.[54] However, these losses will not pass through to a pecuniary beneficiary (whether the pecuniary beneficiary is the marital or exemption trust) and will pass into the residuary trust (whichever of the marital or exemption trust is residuary).[55] Note, however, that these items pass out to the marital and exemption trusts on a pro-rata basis in fractional funding.[56]

J. GST – "generation skipping transfer tax".[57] Another aspect of funding a marital or exempt trust involves the complex generation skipping transfer tax rules. Those rules include the valuation and separate share rules found in the regulations. Refer to the example where a $4,500,000 estate increased in value to $5,000,000 during the course of administration (Paragraph IV.2). Using the pecuniary true worth marital approach, all of the appreciation fell into the exemption trust causing it to protect the additional $500,000 from estate tax upon the surviving spouse's death.

In GST planning, the "inclusion ratio" of zero in an exemption trust is favorable as that trust would escape the GST tax as well. In order to achieve an inclusion ratio of zero, the "applicable fraction" must be 1. The numerator of the fraction is the amount of GST exemption allocated to the exempt trust. In our case where we have no prior use of the GST exemption, the numerator would be $3,500,000, the maximum amount of GST exemption available at death if death occurred in 2009. If the denominator was $3,500,000, the applicable fraction would be 1 and the inclusion ratio would be zero. The denominator is the value of the sum of the property involved in the transfer less any Federal estate tax or State death tax actually recovered from the trust attributable to such property, and less any charitable deduction allowed under I.R.C. §§2055 OR 2522 with respect to such property.[58]

This is illustrated as follows:

Applicable Fraction = $3,500,000/$3,500,000

1 – Applicable Fraction = 0 (inclusion ratio would be zero)

However, what if we funded the exemption trust with $4,000,000 which included the $500,000 appreciation? If we had to use $4,000,000 as the denominator of the applicable fraction, the result would be that the fraction would not be 1 and the inclusion ration would be greater than zero. This outcome would create GST tax. Therefore, the question is "how can we use the $3,500,000, or date of death value, as the denominator to achieve an inclusion ratio of zero?" The answer if found in the following rules found in the GST regulations:

1. Valuation rules.[59]

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[54] I.R.C. §642(h).
[55] Regs. §§1.642(h)-3(b) and 1.642(h)-3(c).

[56] Ibid.
[57] The author credits the article by Marcia K. Fujimoto of Graham & Dunn PC in Seattle, Washington for an excellent discussion of the GST issues. Credit Shelter and Marital Share Formula Clauses and Funding Methods, April 2009.
[58] I.R.C. §2642(d)(2)(B).
[59] Regs. §26.2642-2(b)(2).

a. Pecuniary payments using the reverse marital (up front exemption trust or pecuniary exemption trust).

(1) If this formula is used, the date of death value ($3,500,000) can be used as the denominator provided the pecuniary funding is accomplished by using one of three permitted methods as follows:

(a) The pecuniary funding is done with cash;

(b) The pecuniary funding is satisfied with in-kind assets using date of distribution values (true worth); or

(c) The pecuniary funding is satisfied with in-kind assets using the "fairly representative" approach under Rev. Proc. 64-19.

Note, however, that using property to satisfy any other pecuniary payment in-kind forces the denominator of the applicable fraction to be valued at the date of distribution values which will cause the inclusion ratio to be greater than zero.

b. Pre-residuary pecuniary marital. In order to achieve a zero inclusion ratio, the following rules must be satisfied when funding the residuary exempt trust for GST purposes:

(1) One of the above three rules must be satisfied, and

(2) "appropriate interest" must be allocated to the pecuniary gift.[60]

Failure to meet these two provisions requires that the estate tax value of the assets available to satisfy the pecuniary bequest be reduced by the present value of the pecuniary marital trust. This results in a larger denominator than the numerator and this an inclusion ratio larger than zero.[61]

Avoiding the minimum worth funding approach in either the pecuniary marital or exemption funding is advisable if GST exemption funding is important in the estate planning. When using the true worth or fairly representative funding approaches, providing language regarding "appropriate interest" in the governing document can be advisable. "Appropriate interest" means interest payable from the date of death (or from the date specified under applicable state law requiring payment of interest) to the date of payment at a rate: (1) at least equal to the statutory interest rate, if any, applicable to pecuniary bequests under governing state law, or if none, 80% of the I.R.C. §7520 rate at the death of the transferor; and (2) not in excess of the greater of (A) the statutory rate of interest, if any, applicable to pecuniary bequests, or (B) 120% of the I.R.C. §7520 rate at the death of the transferor.[62] Regulations do provide some relief by deeming appropriate interest to be allocated if either a) the portion is paid or irrevocably set aside within 15 months of death or b) the personal

[60] Regs. §26.2642-2(b)(4)(i).
[61] Regs. §26.2642-2(b)(3).
[62] Regs. §26.2642-2(b)(4)(i).

representative or trustee is required under the governing instrument or state law to allocate to the pecuniary payment a pro rata share of income earned from date of death and date of payment.[63] Oregon law provides for payment of interest on pecuniary bequests beginning with a date that is one year after the appointment of a personal representative until payment at a statutory rate.[64]

2. Separate share rules. When the available applicable exclusion is less than the amount of the available GST exemption, a "reverse QTIP" election can boast the amount of assets available for GST planning. By making this election, the creator of the trust for GST purposes can be the surviving spouse even though the decedent is the transferor for estate tax purposes. By complying with the separate share rules, a pecuniary gift in a revocable trust can, under the reverse QTIP election, qualify for GST exemption planning. A separate share qualifies if a) appropriate interest must be allocated and b) if the pecuniary amount could be satisfied in-kind with other than date of distribution values, the trustee must fund the portion so that the funding carries with it a fair allocation of appreciation or depreciation following the date of death.[65] Failure to meet these conditions results in the portion elected under the reverse QTIP and the residuary non-GST QTIP trust to be combined into one trust to which GST exemption was allocated rather than separate shares. The result will reduce the value of the GST exemption allocation. Savings provisions exist in the regulations as stated above at the end of the immediately proceeding paragraph.

3. Fractional share. If a fractional share approach is used, the division of the marital gift or transfer into trust will qualify for separate share treatment.

V. Conclusion.

Understanding when and how to use the various marital funding formulas can not only lower transfer taxes, such an understanding can more accurately predict the answers to the question in the estate or trust administration of "who gets what?"

Bibliography

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[63] Regs. §26.2642-2(b)(4)(ii).

[64] 116.143 Interest on pecuniary devises. (1) As used in this section, "discount rate" means the auction average rate on 91-day United States Treasury bills, as established by the most recent auction of these Treasury bills and as reported by the United States Department of the Treasury, Bureau of the Public Debt. The discount rate shall be determined, with reference to the most recent auction date, before May 15 and before November 15 of each year.

(2) General pecuniary devises not entitled to a share of income under ORS 116.007 (2) bear interest payable from the residuary estate at the discount rate for a period beginning one year after the first appointment of a personal representative until payment, unless a contrary intent is evidenced in the will or unless otherwise ordered by the court. [1969 c.591 §181; 2005 c.125 §1]

[65] Regs. §26.2654-1(a)(1)(ii).

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