

Post Mortem Estate Planning Class 9

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Tax Issues Concerning Funding Estate Planning Bequests

- Several Issues Arise When Funding Bequests:
 - (1) How Much Is the Bequest Worth?
 - (2) Who is Entitled to Post-death Appreciation?
 - (3) Must Gain Be Recognized When Funding the Bequest (if not, can gain be elected)?
 - (4) Is the Bequest a Beneficiary for Income Tax Distribution Purposes (will they be getting a K-1)?

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Understanding a Will or Trust

- Types of Bequests:
 - **Specific Bequests:** these bequests are transfers of specific assets or money. They arise prior to the residuary bequest. They can be in the form of a formula, and are sometimes called pre-residuary pecuniary bequests.
 - **Residuary Bequest:** this bequest is the final distribution of estate or trust assets and rarely lists any specific asset or money. The residue can be divided among any number of beneficiaries, and sometimes a formula will divide the residue in fractions (called a fractional share approach).

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Prototype Marital Deduction Estate Plan

- The Prototype Marital Deduction Estate Plan will comprise one of the following:
 - (1) Pecuniary Pre-residuary Marital Trust with Credit Shelter Residuary Trust (common); or
 - (2) Pecuniary Pre-residuary Credit Shelter Trust with Marital Residuary Trust (rare); or
 - (3) Fractional Share Residuary Marital and Credit Shelter Trusts (less common)

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Revenue Procedure 64-19

- A pecuniary marital bequest funded using estate tax values will be disqualified if the marital share is not funded with assets fairly representative of the post-death appreciation.
- Two Permitted Approaches:
 - (1) Minimum Worth
 - (2) Fairly Representative

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Pre-residuary Plans: True Worth: FMV at Date of Distribution

- Assets must be valued for purposes of funding bequests. One method is to value them at the date of distribution.
- The True worth method will cause gain on funding the pecuniary share if assets have appreciation after the date of death.
- An executor could allocate assets in kind between the pecuniary share and the residuary share without the limitations of Rev. Proc. 64-19.

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Fractional Share Approach

- In a fractional share approach, the residue is divided into shares. Post-death appreciation is allocated to the shares according to the relative sizes of the shares.
- No gain or loss is recognized on funding because the shares are not pecuniary amounts. No Rev. Proc. 64-19 concerns since distribution values are used.
- If the shares are funded (in full or in part) at different times, the fractions will need to be adjusted to accommodate these distributions.
- If the fractional share method is a pick and choose approach, the executor will have discretion to distribute assets in kind between the fractional shares.

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Minimum Worth

- For distribution purposes, assets are valued at the lesser of FMV at date of distribution or estate tax value.
- No gain is recognized on funding. Gain may be elected under 643(e)(3). Loss would always be recognized even without a 643(e)(3) election.
- Disadvantage to minimum worth formula is that the pre-residuary marital share can be over-funded. Would never use with a Pre-Residuary Credit Shelter Trust Plan as Rev. Proc. 64-19 would disqualify the marital deduction.

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Hybrid Minimum Worth-True Worth Instruction Clause

- While no gain is recognized under a pure minimum worth formula, sometimes it is beneficial to recognize gain. Under a pure minimum worth clause, a Section 643(e)(3) election can be made, but it would require election on all assets distributed during the year.
- It is possible to have a minimum worth clause that allows the executor to value the property at a value between minimum worth and true worth, allowing gain recognition without the need for a Section 643(e)(3) election.

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