

QTIP Trusts

By Richard J. Shapiro, J.D.

In a married couple's "typical" estate plan, upon the first spouse's death, assets are left directly to the surviving spouse. While this planning strategy is appealing in its simplicity, such planning may cause unnecessary estate taxes to be incurred, or assets may end up passing to unintended beneficiaries. One planning tool that can solve these problems is the qualified terminable interest property, or "QTIP" trust. A QTIP trust allows for assets to be left for a surviving spouse in a manner that qualifies for the estate tax marital deduction – that is, the assets in the QTIP trust are *not* included in the taxable estate of the first spouse to die – while providing the surviving spouse with full income and limited principal rights to the trust property.

Since property passing as an outright distribution to a surviving spouse will also qualify for the estate tax marital deduction, why might a person consider using a QTIP trust? This strategy is most frequently used in a second (or subsequent) marriage, where each spouse may wish to make absolutely sure that *their* assets would ultimately pass to their own children, while at the same time providing economic benefit to the surviving spouse. Even in a first marriage, however, QTIP trusts may be attractive to help protect the assets for the children and future generations in the event the surviving spouse were to remarry. The QTIP trust can be structured so that the surviving spouse will receive trust income and have some access to principal, but in the event of a remarriage of the surviving spouse, their new spouse would have no inheritance rights or ability to access any of the QTIP trust assets in the event of that the surviving spouse and the new spouse were to divorce.

Most QTIP trusts are included in a will or revocable living trust, and are designed to go into effect after the death of the first spouse. As an alternative or as a supplement to these "testamentary" QTIP trusts, it is sometimes desirable to establish a "lifetime" QTIP trust. This planning technique is most often used as an estate tax planning vehicle in larger estates where one spouse owns a majority of the couple's assets and is unwilling or unable to transfer assets directly to the surviving spouse. For example, assume a couple in a second marriage has total assets of \$3,000,000, but only \$500,000 of assets are in the wife's name. If the wife dies first and leaves the \$500,000 to her children, no estate tax is due because she can take advantage of the current \$2,000,000 federal estate tax exemption. However, assuming the husband subsequently dies in 2007 with an estate of \$2,500,000, \$500,000 of his assets will be subject to federal estate tax.

Assume instead that the husband creates a lifetime QTIP trust funded with \$500,000 of assets. The QTIP trust would provide the wife with all trust income during her lifetime, and could be structured to allow for distributions of principal, typically for the broad purposes of health, education, support and maintenance. The wife may be a Cotrustee, or the husband may elect to name an independent trustee to serve alone. If the wife were to die first, her total taxable estate would be \$1,000,000, all of which would qualify for the federal estate tax exemption. While the wife could still leave her \$500,000

of assets to her own children, the QTIP trust terms would presumably direct that the QTIP assets remaining after the wife's death would be distributed to the husband's children, either outright or in trusts created for their benefit. If the husband subsequently dies in 2007 owning \$2,000,000 of total assets, *no* federal estate tax would be due, as the husband would be able to take full advantage of the \$2,000,000 federal estate tax deduction.

Richard J. Shapiro is a partner with the Middletown law firm of Blustein, Shapiro & Rich, LLP. Mr. Shapiro is a member of the National Network of Estate Planning Attorneys, the National Academy of Elder Law Attorneys, the New York State Bar Association (Trusts and Estates and Elder Law Sections), and the Hudson Valley Estate Planning Council. He can be reached at (845) 692-0011 or at rshapiro@mid-hudsonlaw.com. The information in this article is for general information purposes only and is not, nor is it intended to be, legal advice, including legal advice for Internal Revenue Code purposes as described in IRS Circular 230.