

## **Patti Spencer's Taxing Matters Column for June 09, 2008**

### **Inter-vivos QTIP (no, its not in the medicine chest)**

When I was in law school, I remember being absolutely shocked to discover that when a person transferred property to his or her spouse, the transferor was making a gift. If the value of the transfer was large enough, a gift tax was due. Imagine that — paying gift tax for transferring property to your spouse!

Those days are over, at least, in most cases. There is now an unlimited marital deduction. That means that while making a transfer of property to your spouse is still a gift, such gifts are 100% deductible and do not generate a gift tax. There are a couple of catches, though, and a big one is that such gifts must not be terminable interests. A terminable interest is one that terminates on the lapse of time or on the occurrence or nonoccurrence of a future event.

It is a very common estate planning recommendation to a married couple that they divide assets between them. These interspousal gifts are commonly made in order to take full advantage of each spouse's federal estate tax exemption. The current federal exemption is \$2 million. It is scheduled to rise to \$3.5 million 2009, then in 2010 there is no estate tax at all. In 2011 the tax is back with a \$1 million exemption. It is expected that tax legislation after the election will "even out" the exemption, but at what level is anyone's guess.

If spouses divide assets between them so that each holds separately titled assets equal to the amount of the exemption and they have the appropriate estate planning documents with by-pass trusts in place, the exemption can be effectively doubled for a married couple.

One can't let the tax tail wag the dog. Sometimes these transfers cannot be made because of nontax considerations. Sometimes significant assets are in restricted stock or qualified plans or partnerships with restrictions on transfers. Sometimes the family situation makes such transfers inappropriate. For example, when it's a second marriage and each spouse has children from the first marriage, asset transfers like this will disrupt the planned distribution of inheritances.

When the estate planning consideration to reduce estate tax would militate toward a division of assets but other circumstances make an outright transfer inappropriate, there is a solution: the Inter-vivos QTIP trust. QTIP is an acronym for qualified terminable interest in property. Inter-vivos means that the trust is made during the donor's life, not at his death.

A QTIP trust is an irrevocable trust. The minimum requirement for a QTIP trust is that the spouse be given the income from the trust for his or her life.

This right can never be taken away.

The right to income cannot be conditioned on not remarrying. If the trust is elected to be QTIP trust on the gift tax return, it is treated as if it were owned by the spouse who received the income for estate tax purposes, thus fulfilling the need to transfer assets to the spouse to use his or her exemption.

The significance of a QTIP is that a transfer to a trust like this qualifies for the marital deduction even though it is a terminable interest.

That means that the donor spouse can have his cake and eat it, too.

Both spouses' exemptions can be utilized, but because the property is transferred to a trust, not to the spouse directly, the donor spouse retains control of the ultimate disposition of the property.

The minimum requirement for a QTIP trust is that it provides for payment of the income to the surviving spouse for life.

Unfortunately, many lawyers stop there.

Keep in mind that this trust will continue for the life of the spouse, even after the donor spouse dies. Much more flexibility can be added if appropriate to the situation.

The spouse can be given principal from the trust in the trustee's discretion or in accordance with a standard for health, maintenance and support.

The spouse can be given the annual right to withdraw an amount of principal equal to the greater of (1) \$5,000 or (2) 5 percent of the value of the trust principal. (Don't include this power if the surviving spouse is the trustee.) Also, the spouse can be given a power to designate who should receive the trust property after his or her death by will.

An Inter-vivos QTIP trust is one of a myriad that can be used creatively in estate plans.