The Lifetime QTIP Trust or How to Maintain Control of Your Estate and Keep Spouse No. 2 Happy

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Estate Planning for couples in a second or later marriage can be tricky, particularly when one spouse is significantly wealthier than the other. One solution for allowing the well-to-do spouse to maintain control of his or her assets while keeping the other spouse happy is the Lifetime QTIP Trust. In this issue, you will learn what a Lifetime QTIP is, the multiple benefits this special type of trust can provide to married clients with lopsided estates, and how you might alter a client's investment strategy when using it.

The Basics of Creating a Lifetime QTIP Trust

In the estate planning world a "QTIP Trust" has nothing to do with those handy cotton swabs used for cleaning ears, applying cosmetics, or making children's crafts. Instead, QTIP refers to a "Qualified Terminable Interest Property Trust," which is a fancy term for a type of trust that allows a wealthier spouse to transfer an unrestricted amount of assets into trust for the benefit of a less wealthy spouse free from estate and gift taxes.

Many married couples have estate plans that make use of a QTIP Trust after the death of one spouse using the so-called "AB Trust" strategy. After the first spouse dies, the "B Trust" holds an amount equal to the federal estate tax exemption ($5.43 million in 2015) and the "A Trust" holds the excess. Under this strategy the "A Trust" is in fact a "QTIP Trust" which qualifies for the unlimited marital deduction, meaning that property passing into the trust will not be subject to estate taxes until the surviving spouse dies.

Here is an example: Fred and Susan have both had previous marriages. Fred has two children from his prior marriage and Susan has three, and their estates are disproportionate – Fred is worth $2 million and Susan is worth $10 million. With the AB Trust strategy, if Susan dies first the B Trust is funded with $5.43 million and the A Trust is funded with $4.57 million. No estate tax will be due at Susan's death since the B Trust uses up her federal estate tax exemption and the A Trust qualifies for the unlimited marital deduction. In addition, when Fred later dies, the A and B Trusts can be drafted so that what is left passes exclusively to Susan's three children (or whomever else she chooses, much to the chagrin of Fred's children).

What if instead of creating and funding the QTIP Trust *after* Susan dies, she creates and funds the QTIP Trust for Fred's benefit with tax-free gifts *while she is still alive*? This is the "Lifetime QTIP Trust."

Planning Tip: QTIP Trusts created during life or after death must meet certain requirements to qualify for the unlimited marital deduction:

- The trust must be irrevocable.
- The Lifetime QTIP Trust must be created for the benefit of a spouse who is a U.S. citizen.
- The spouse must be entitled to receive all of the net income from the trust at least annually.
- The spouse must have the right to demand that non-income producing property be converted into income-producing property.
- The spouse must be the only one who has the power to appoint trust property.
- For Lifetime QTIP Trusts, a federal gift tax return (Form 709) must be timely filed. Form 709 is due on or before April 15 of the year following the year a gift is made to the trust.
- The spouse does not need to have a right to distributions of principal from the trust although they are permitted.
- A Lifetime QTIP Trust can provide that if the beneficiary spouse dies first, the grantor spouse can become the income and principal beneficiary, and the trust assets will be excluded from the grantor spouse's estate. (Yes, you read that correctly.)

While at first glance QTIP Trusts may appear to be restrictive due to their multiple technical requirements, in reality they are quite flexible and will work well in a variety of situations.

Planning With a Lifetime QTIP Trust Offers a Multitude of Benefits

Outright gifts to a spouse during life or after death lead to total loss of control. For married couples with lopsided estates and families from prior marriages, the problem is exacerbated by the difference in wealth – while the well-to-do spouse will be just fine if the less wealthy spouse dies first, the opposite is not true. A Lifetime QTIP Trust offers the following benefits to this type of couple:

- The wealthy spouse can create and fund a Lifetime QTIP Trust without using any gift tax exemption.
- Unlike the estate tax exemption, the generation-skipping transfer tax exemption is not portable. A Lifetime QTIP Trust can provide an opportunity to make use of the less well-to-do spouse's generation-skipping tax exemption.

- During the beneficiary spouse's lifetime, he or she will receive all of the trust income and may be entitled to receive trust principal for limited purposes.
- When the beneficiary spouse dies the assets remaining in the lifetime QTIP trust will be included his or her estate, thereby making use of the less wealthy spouse's otherwise unused federal estate tax exemption.
- If the beneficiary spouse dies first, the remaining trust property can continue in an asset-protected, lifetime trust for the grantor spouse's benefit (subject to applicable state law), and the remainder will be excluded from the grantor spouse's estate when he or she dies.
- After both spouses die, the balance of the trust will pass to the grantor spouse's children and grandchildren or other beneficiaries chosen by the grantor spouse.

Planning Tip: As with other types of estate planning, Lifetime QTIP Trusts are not "one size fits all" and must be specifically tailored to each client's unique family dynamics and financial situation. In addition, only an attorney experienced in implementing advanced estate planning techniques should be drafting Lifetime QTIP Trusts for your clients.

How You Might Adjust a Client's Investment Strategy When Using a Lifetime QTIP Trust

In the estate strategy we have discussed, the Lifetime QTIP Trust differs from the conventional "A Trust" it might replace in that the surviving spouse has access to the Lifetime QTIP Trust's investment income but not necessarily the principal. For example, the lifetime QTIP Trust might permit distributions of principal to the spouse for health, education, maintenance and support only. So while any particular client's own goals, risk tolerance, time horizon, tax bracket, etc. might change this, all else being equal, the investment strategy for the Lifetime QTIP Trust would focus more on generating income to offset the limited access to principal, assuming income is needed at the time.

This might mean that your recommendations to your client among publicly traded securities would skew more toward high-dividend stocks, high-yield corporate and muni bonds, mortgage real estate investment trusts (REITs), business development corporations (BDCs), and certain master limited partnerships (MLPs), as well as high-income exchange-traded funds (ETFs), closed-end funds (CEFs), and mutual funds. In the non-traded arena you might consider REITs, BDCs, or certain life settlement debt instruments. Or, if your client is an accredited investor, you might consider high quality private debt or equity, provided the income would warrant the risk.

For advisors who tend toward annuities for their strategy, because assets in annuities would forfeit the Lifetime QTIP Trust's step-up in basis at the second death, a better location to use them might be the "B Trust" (bypass trust), where there is no such second-death step-up anyway. That being said, if your client believes the lost opportunity to use the Lifetime QTIP

Trust's step-up is less important, you might consider an annuity with a reasonably high guaranteed income coupled with an enhanced death benefit to replace the typical depletion of capital stemming from the combination of annuities' fees and their distributions.

Finally, a word for insurance agents. Due to the Lifetime QTIP Trust's focus on income, *all else being equal*, this strategy possibly will impair the capital that would eventually be distributed to the remainder beneficiaries, at least when compared to what they might have received had the holdings been structured less for income and more for capital gains or capital preservation. Thus, agents might wish to evaluate whether the benefit to these heirs of a second-to-die life insurance policy in an irrevocable life insurance trust (ILIT) would warrant the total impact of sustained insurance premiums.

Which of Your Clients Need a Lifetime QTIP Trust?

If you have clients in a second or later marriage with uneven assets, please call our firm immediately. We will help you and your clients determine what will work best for them and their families. And, if you have any questions about Lifetime QTIPs or other estate planning techniques, we're here for you. We'd be happy to answer your questions, helping you better serve your clients, place products, identify assets not yet under management, and support your relationship with your clients and their adult children.