

QTIP Trusts Allow You Control Over Gifted Assets

Married couples with more than \$1.25 million in assets can achieve significant estate tax savings -- as much as \$252,250 -- using estate plans that take full advantage of each spouse's applicable exclusion amount and the unlimited marital deduction. In many situations, however, taking full advantage of the exclusion means transferring property from one spouse to another so that each has an amount at least equal to the applicable exclusion amount. While transferring property, especially between spouses with greatly unequal wealth, can present estate planning and personal challenges, effectively designed qualified terminable interest property (QTIP) trusts can help you overcome difficulties and save estate taxes.

The applicable exclusion amount allows each individual to transfer up to \$625,000 of assets in 1998 to anyone without incurring gift and estate taxes. (This amount will increase until it reaches \$1 million in 2006.) The unlimited marital deduction allows spouses to transfer property between themselves, either outright or through specific types of trusts, free of gift and estate taxes.

To take full advantage the applicable exclusion amount, you and your spouse must each own \$625,000 of assets in your own names. If one of you owns less, the wealthier of you (the donor spouse) can transfer assets to the other (the donee spouse) to make up the difference. Let's assume you are the donor spouse. You may transfer assets through outright gifts or by transferring the property to a qualifying marital deduction trust for the benefit of your spouse.

Enter the QTIP Trust

By using a lifetime QTIP trust, you can make the initial transfer of assets to your spouse free of gift tax without giving him or her any more control over the trust property than you choose. You may retain direct investment control by acting as a trustee (although this is generally not advisable) or keep only indirect control by choosing a trustee who shares your investment philosophy. QTIP trusts may also include creditor and spendthrift protection for trust principal.

QTIP Trust Safety

When establishing a QTIP, be sure to put proper safeguards in place so that the transferred property will not be brought back into your estate when your spouse dies. Although your spouse will be entitled to all the income from the QTIP trust during his or her lifetime, you may choose who the ultimate beneficiaries of the trust will be after your spouse's death or provide in the trust agreement that your spouse may, in his or her will, choose the ultimate beneficiaries of the trust from a class of beneficiaries that you define. Finally, you can design the trust in such a way that, if your spouse dies before you, you may use the property with no estate tax consequence.

While you can exercise significant control over assets in a QTIP trust, your control is not absolute. For instance, once you place the property into the trust, you cannot get the property back in the event of divorce. While outright gifts are generally not deemed marital property in the divorce context, divorce courts commonly recognize that some transfers were not intended as gifts per se, but rather were made for estate planning purposes. So, unlike when you use a QTIP trust, making outright gifts can leave open the possibility that you might receive part or all of the property back in a divorce.

Reap QTIP Trust Rewards

Lifetime QTIP trusts may be ideal planning vehicles for married couples with disparate wealth. They can provide tax savings while allowing the wealthier spouse to maintain some control over the transferred property. With proper planning, you and your spouse can reap the rewards of a QTIP trust.

Should You Use a Gift Or a QTIP Trust?

When choosing whether to gift property or transfer it using a QTIP trust, consider questions such as:

- What would happen to the property if you and your spouse divorce?
- Is your spouse financially responsible? What are his or her spending habits?
- How may your spouse dispose of the property through gifts or through his or her own estate plan? For example, if you divorce and your spouse remarries, will the property be left to a new spouse rather than your children?
- Has the asset you will transfer significantly appreciated in value? If it has, take into account the life expectancy of each spouse to plan for a step-up in the asset's basis.
- How will the transfer affect your financial position? For example, if you transfer property, will both you and your spouse then be required to guarantee new loans?

If these or any other issues cause you concern, or if your spouse is uncomfortable receiving an outright gift, consider using a lifetime QTIP trust.