

Marital Deduction and QTIP Trust

The Concept

The marital deduction allows property to be transferred between spouses without triggering either the federal estate tax or federal gift tax, either during life or at death. To qualify for the marital deduction, certain requirements must be met:

- Spouses must be legally married.
- The spouse receiving the transfer must be a U.S. citizen.
- Generally, property transferred to the spouse can't be a "terminable interest," defined as an interest in property that can expire after the passage of time, or the occurrence or non-occurrence of an event. One exception, however, is qualified terminable interest property (QTIP).

The QTIP Exception

- Qualified terminable interest property is property in a decedent's estate that, even though it's a terminable interest, can still qualify for the estate tax marital deduction.
- The term also includes property given to a spouse during life that qualifies for the gift tax marital deduction, even though it's subject to similar restrictions.
- A terminable interest must meet the legal criteria required of a "qualified" terminable interest, such as a lifetime income interest. The executor must make an election to treat the trust as a QTIP trust.

The Process

- The will of the first spouse to die directs that certain property be placed in a QTIP trust.
- The executor elects whether to qualify the property for the marital deduction in the deceased spouse's estate.
- No one can have a power to appoint any part of the property to anyone other than the surviving spouse.
- All of the trust income must be paid to the surviving spouse no less frequently than annually for life.
- The surviving spouse has the right to force conversion of nonproductive property into productive property.
- When the surviving spouse dies, the trust principal passes to beneficiaries designated by the first spouse.

The Tax Picture

- At the death of the first spouse, the marital deduction may be claimed even though the transfer is a terminable interest.
- At the subsequent death of the second spouse, the transfer will be included in the gross estate, even though the spouse had only limited rights to the property.

The Benefits

There are several reasons why individuals might choose QTIPs as part of their planning. Among them:

- **Flexibility in estate arrangements.** Since the final decision whether to qualify the QTIP property for the marital deduction is delayed until after the estate owner's death, the surviving spouse's circumstances at that time and those of the other beneficiaries can be taken into account.
- **Lifetime income for a surviving spouse.** The surviving spouse can be assured of receiving all of the income from the QTIP property for life.
- **Placing restrictions while still claiming the marital deduction.** The estate owner can restrict the ultimate disposition of the QTIP property without sacrificing the marital deduction.
- **The chance to decide whether to leave property outright to a surviving spouse.** It may not be appropriate to leave property outright to a surviving spouse—perhaps because the spouse is aged, infirm or not sophisticated in financial affairs or property management. The QTIP trust can manage property for a spouse's benefit.
- **Children of a prior marriage.** In a second marriage, the first spouse to die can be assured that the trust will provide lifetime income to a surviving spouse and that the property will pass eventually to his or her children or other heirs rather than to a spouse's unrelated children from a prior marriage.
- **Remarriage questions.** If property is left outright to a surviving spouse who later remarries, the property could end up in the hands of a subsequent spouse. The QTIP trust provides for a surviving spouse, but retains control over the ultimate disposition of property.

The Bottom Line

A QTIP trust provides a way to take full advantage of the federal gift and estate tax marital deduction while helping an individual achieve other estate planning objectives—reducing taxes, providing income to survivors, securing professional property management, and other objectives.

Summary

What is the Marital Deduction?

The marital deduction provides that an unlimited amount of property can be transferred between spouses—either during life or at death—without triggering either the federal estate tax or the federal gift tax.

For the transfer to qualify, certain requirements must be met. One is that property given or left to the spouse generally cannot be a “terminable interest.” That’s an interest that can expire after the passage of time or the occurrence—or non-occurrence—of an event.

This general rule notwithstanding, tax law does allow certain types of “terminable interests” to qualify for the marital deduction. QTIP trusts are an example.

What Is Qualified Terminable Interest Property?

Qualified terminable interest property (QTIP) is property in a decedent’s estate that, even though it’s a terminable interest, can still qualify for the estate tax marital deduction. The term also includes property given to a spouse during life that qualifies for the gift tax marital deduction, even though it’s subject to similar restrictions.

For a terminable interest to qualify for either the estate or gift tax marital deduction, it must meet certain legal criteria of a “qualified” terminable interest. This may be a lifetime income interest. The executor must make an election to treat the trust as a QTIP trust.

How Does a QTIP Trust Work?

The will of the first spouse to die directs that certain property be placed in a QTIP trust. The estate executor elects to qualify the property for the marital deduction. All of the income from the trust must then be paid to the surviving spouse no less frequently than annually for life.

No one can have a power to appoint any part of the property to anyone other than the surviving spouse. At the spouse’s subsequent death, the trust principal passes to beneficiaries designated by the spouse who created the trust.

During the period that the trust is providing the surviving spouse with a lifetime income, the spouse has the right to require conversion of nonproductive property into productive property.

How Is a QTIP Trust Taxed?

At the first spouse’s death, the marital deduction may be claimed—even though the transfer is a terminable interest. At the second spouse’s death, the transfer will be included in that spouse’s gross estate, even though the spouse had no ownership or interest in the property.

Summing Up: Advantages of the QTIP Trust

A QTIP trust is an effective, flexible tool. Without leaving the property outright to a spouse, a QTIP trust can provide lifetime income to a surviving spouse. It can place restrictions on the property and still claim the marital deduction. A QTIP trust can also be structured to direct the disposition of property in the event of a surviving spouse’s subsequent remarriage, easing concerns about how the second marriage might affect the rights of children from the first marriage and other beneficiaries.

HOW THE MARITAL DEDUCTION WORKS

1

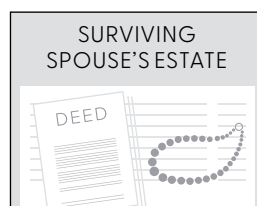
Property passing at the first spouse's death to a surviving spouse qualifies for the estate tax marital deduction if it's not a disqualified terminable interest.

2

The deduction is unlimited at the first death and enables the surviving spouse to receive the property without any estate tax liability.



SURVIVING SPOUSE



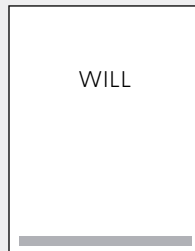
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At the surviving spouse's subsequent death, property passing through the estate will not qualify for the marital deduction (unless the surviving spouse remarries). So, the marital deduction essentially delays the estate tax until the second death.

HOW THE QTIP TRUST WORKS

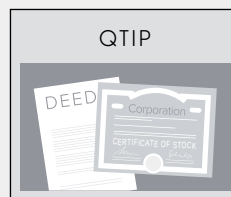
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The will of the first spouse to die directs that certain property be placed in a QTIP trust. The executor elects whether to qualify the property for the marital deduction in the deceased spouse's estate.



2

All of the income from the trust must be paid to the surviving spouse at least annually. The surviving spouse has the right to force conversion of nonproductive property into productive property to increase the trust income.



3

The trust principal passes to the first spouse's designated beneficiaries after the death of the second spouse.



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