

An Advisor's Guide to Qualified Terminable Interest Property Trusts

"A diamond is forever" is a popular saying. Estate planning does not have a time horizon that long, but it does seek to protect a family's wealth and provide them with financial stability for years to come.

Around Valentine's Day, many couples are looking for ways to display their affection. By understanding the nuances of *qualified terminable interest property* (QTIP) trusts and ways to customize them, advisors can help clients show love to their spouse with a gift that lasts a lifetime—and in many cases, even longer.

What Is a QTIP Trust?

A QTIP trust is an irrevocable trust that allows a surviving spouse to benefit from their deceased spouse's assets while ensuring that those assets ultimately pass to beneficiaries designated by the deceased spouse.

Key features of a QTIP trust include the following:

- **Spousal income for life.** The surviving spouse must receive the income generated by the trust assets at least annually for the rest of their life, potentially giving them financial security and support.
- **Designated remainder beneficiaries.** The trustmaker designates the beneficiaries who will receive the trust assets upon the surviving spouse's death. Such beneficiaries could be children, a charity, or other entities or loved ones.
- **Control over assets.** The trustee manages the trust assets and ensures that they are used in accordance with the (customizable) trust terms created by the deceased spouse. Depending on the desired level of asset protection, the spouse may serve as trustee of their trust.

QTIPs may be particularly useful for clients who want to provide for a surviving spouse but who also wish to direct the eventual distribution of the trust to different beneficiaries. Clients can simultaneously take advantage of the unlimited marital deduction and retain control over their assets "from the grave," an option that did not exist until legislative reforms in the Economic Recovery Tax Act of 1981.

Important QTIP Trust Features

Although a QTIP trust is just a trust, it is special. Certain important and unique characteristics may make it the right solution for your married clients.

- **Restricted principal access.** The trustmaker can specify whether and under what circumstances the surviving spouse may access the trust's principal. This restriction helps protect the trust's assets from being mismanaged or prematurely spent. Such provisions may be useful if the trustmaker has concerns about their spouse's ability to manage assets.
- **Marital deduction.** A QTIP trust allows the trustmaker to take advantage of the unlimited marital deduction to minimize estate taxes. Qualified transfers to the trust for the benefit of a US citizen spouse will not be subject to federal estate tax at the trustmaker's death (although the assets held in the trust may be subject to estate tax at the surviving spouse's death).

- **Protection from creditors.** Assets held in a QTIP trust are generally protected from the surviving spouse's creditors and from claims in any future remarriage. The level of asset protection will depend on the level of control the surviving spouse has over the trust's assets. After assets have been distributed to the surviving spouse, they are more vulnerable to a creditor's claim.
- **Balancing interests.** A QTIP trust can provide income for the surviving spouse while preserving the trust's principal for the children, allowing both to benefit from the trust as the grantor sees fit. This arrangement may prove useful when there are children from a previous marriage or another unique family dynamic.

Customizing a QTIP Trust

One of the strengths of a QTIP trust is its ability to be customized to a client's needs and circumstances. Here are some top-level customization options you may want to discuss with clients:

- **Distributions of principal.** The surviving spouse is entitled to income generated by the trust at least annually, but the trustmaker can dictate whether and under what circumstances the trustee can distribute the principal to the spouse. Distributions can be structured in several ways, including only for ascertainable standards (health, education, maintenance, and support) or for hardship. They can also give the trustee sole discretionary authority to distribute principal based on the spouse's needs. The trustmaker can even restrict principal distributions entirely to preserve the remaining beneficiaries' trust assets.
- **Granting the spouse control.** Although the trustmaker has the ultimate say on the final distribution of assets, they can grant the surviving spouse some degree of control over the trust using strategies such as a *testamentary limited power of appointment*, which lets the surviving spouse choose how the remaining trust assets are distributed upon their death among a defined group of beneficiaries predetermined by the trustmaker (e.g., children, grandchildren, or other family members).

Additional Options and Considerations

Although a QTIP trust may not be the most romantic gift, it could prove more thoughtful, caring—and, years from now, more valuable—than a standard Valentine's Day purchase. Clients can be sold on them as a way to express their love in a controlled, future-minded manner that supports their legacy goals.

With tax season officially underway, let's discuss using estate planning tools like QTIPs to meet clients' wealth preservation goals this February.