TAXATION

CALIFORNIA
LAWYERS
ASSOCIATION

presents

2024 Estate and Gift Tax Conference

Panel 9: Planning with Inter-Vivos QTIP Trusts – The Best Way to Use All Transfer Tax Exemptions?

Thursday, March 21, 2024

4:00pm - 5:00pm

Speakers: George Karibjanian

Conference Reference Materials

Points of view or opinions expressed in these pages are those of the speaker(s) and/or author(s). They have not been adopted or endorsed by the California Lawyers Association and do not constitute the official position or policy of the California Lawyers Association. Nothing contained herein is intended to address any specific legal inquiry, nor is it a substitute for independent legal research to original sources or obtaining separate legal advice regarding specific legal situations.

© 2020 California Lawyers Association
All Rights Reserved

The California Lawyers Association is an approved State Bar of California MCLE provider.

INTER-VIVOS QTIP TRUST PLANNING STRATEGIES - USING THE SPOUSE'S APPLICABLE EXCLUSION AMOUNT AND GST EXEMPTION AND PLANNING WITH A LIFETIME "DEATHBED" TRUST

California Lawyers Association – Taxation Section
2024 Estate and Gift Tax Conference

March 21, 2024
San Francisco, California

GEORGE D. KARIBJANIAN
Franklin Karibjanian & Law PLLC

Boca Raton Office:
150 East Palmetto Park Road, Suite 800
Boca Raton, Florida 33432

Washington, DC Office:
1101 Seventeenth Street, N.Claire., Suite 820
Washington, D.C. 20036

Direct: 202-495-2676
Fax: 202-463-3060
gkaribjanian@fkl-law.com

GEORGE D. KARIBJANIAN

Boca Raton
Direct: (561) 208-1272

DC
Direct: (202) 495-2676

gkaribjanian@fkl-law.com

George D. Karibjanian is a Founding Member of Franklin Karibjanian & Law, a national boutique law firm based in Washington, D.C., with additional offices in Boca Raton, Florida and Naples, Florida. George practices predominantly in the firm's Boca Raton office. George is Board Certified by the Florida Bar in Wills, Trusts & Estates and is a Fellow in the American College of Trust and Estate Counsel.

George divides his time between the Boca Raton and Washington offices, spending the majority of his time in Boca Raton. George is admitted to practice in Florida, the District of Columbia, Maryland and Virginia.

He earned his B.B.A. in Accounting from the University of Notre Dame in 1984, his J.D. from the Villanova University School of Law in 1987, and his LL.M. in Taxation from the University of Florida in 1988. George has practiced his entire legal career in South Florida (over 35 years), practicing exclusively in the areas of estate planning and probate and trust administration, and also represents numerous clients with respect to nuptial agreements. George has participated in over 225 formal presentations, either individually or as part of a panel discussion, to national, state-wide and local groups, and has over 80 publication credits in national and regional periodicals and journals. Born and raised in Vineland, New Jersey (in the heart of South Jersey), George has called Boca Raton home since 1988.

On the topic of the Uniform Voidable Transactions Act and its potential negative effect on estate planning, George has published many articles and has lectured in cities across the nation such as Las Vegas, Nashville, New York, Phoenix, Portland (Or.), San Diego, San Francisco, and Wilmington (Del.), and presented webinars to groups in South Dakota and Alaska. George has also presented on the topic in October 2016 at the 42nd Annual Notre Dame Tax and Estate Planning Institute in South Bend, Indiana.

On the topic of same-sex estate planning, George has lectured at various conferences and estate planning councils throughout the United States and has published numerous articles in publications such as Steve Leimberg's LISI Estate Planning Newsletters, Trusts & Estates Magazine and the Florida Bar Journal. George has also been quoted by several publications and websites.

George was presenter at the 48th Annual Heckerling Institute on Estate Planning in Orlando, Florida on January 15, 2014, speaking on a panel discussion titled, "Living and Working with the Uniform Principal and Income Act," focusing on the tax effects on the power to adjust trust principal to income, the power to convert an income trust to a unitrust, comparing the various unitrust statues and focusing on potential litigation facing fiduciaries in this area.

George's other lectures have included topics such as Portability, Decanting, Trustee Selection and Duties, Current Developments in Estate Planning and Taxation, Representing a Client with Potential Capacity Issues, Whether a Supplemental 706 is Required, Inter-Vivos QTIP Planning, Prenuptial Agreements for the Estate Planner, the Advantages and Disadvantages of Domestic Asset Protection Trusts and Differences in the States' Version of the Uniform Trust Code.

For the American Bar Association's Section of Taxation, he is a past Co-Chair of the Estate and Gift Tax Committee; was the Chairperson for the Section's 2016 Comments on the Basis Consistency Regulations, the Chairperson for a 2011-12 Section Task Force Subcommittee Advocating Changes to the Portability Provisions Added by the 2010 Tax Act; and a contributing draftsman to the Section's 2012 Comments on decanting.

For the American Bar Association's Section of Real Property Trusts & Estates, Income and Transfer Tax Planning Group, he is a current Vice Chair of the Income Tax Planning Subcommittee, and a past Co-Chair of the Estate and Gift Tax Subcommittee.

For the Florida Bar's Real Property Probate & Trust Law Section, he is a past Chair of the Asset Protection Committee; the Co-Vice Chair – Probate & Trust and National Events Editor for the Section's "ActionLine" publication from 2012-2022; the Co-Chairperson of the RPPTL Ad Hoc Committee regarding potential statutory changes in light of a change in Florida's DOMA laws; a member of the Ad Hoc committee to study changes to Florida's decanting statutes (which led the 2018 legislation enacting the suggested changes); the Chairperson and primary draftsman of the Section's 2012 comments to the IRS on decanting, a member of the RPPTL Ad Hoc Committee that drafted a statutory change in response to Florida's Morey v. Everbank decision; and a member of the Section's Executive Council from 2012-2022.

George is also a member of the Greater Boca Raton Estate Planning Council, the Washington, D.C. Estate Planning Council and the South Palm Beach County Bar Association.

George currently serves on the Professional Advisory Committee for George Snow Memorial Scholarship Foundation. Previously, George served on the Professional Advisory Committee for the Boca Raton Museum of Art from 2011 to 2019 and served on the Board of Directors for the Palm Beach County Wealth & Estate Planning Seminar from January 2015 until its suspension in January 2019. George also served as President and a member of the Board of Directors of the Notre Dame Alumni Club of Boca Raton (1996-1997), a member of the St. Jude's Church (Boca Raton) Financial Education Council (1994-1996), and Vice President and a member of the Board of Directors of the Boca Raton Girls Fastpitch Softball Association (2004-2008).

Part I – The Lifetime QTIP Trust and Using the Spouse's Applicable Exclusion Amount and GST Exemption

Introduction

- As part of the 2017 Tax Cuts and Jobs Act (the "2017 Act"), each individual's estate and gift tax exemption, otherwise known as the "basic exclusion amount" or "BEA", as well as the exemption from the generation-skipping transfer ("GST") tax (such exemption is referred to as the "GST Exemption"), was doubled.
- Based on the required annual inflationary adjustment calculations, in 2024, each individual will have a BEA of $13,610,000 and a GST Exemption of $13,610,000 (collectively, the BEA and the GST Exemption may be referred to as the "Exclusions").

Introduction

- For many wealthy married couples, the assets are concentrated in one spouse (referred to as the "More Affluent Spouse").
- The less wealthy spouse (the "Less Wealthy Spouse") usually owns little or no assets, which presents the distinct possibility that he or she will waste his or her Exclusions.
- This was one problem that portability was intended to resolve; if the Less Wealthy Spouse died first, his or her unused AEA amount could pass to the More Wealthy Spouse.
- However, portability only applies to the AEA; currently, there is no portability for the GST tax.

Introduction

- How, then, can the More Wealthy Spouse not only utilize the Less Wealthy Spouse's AEA, but also his or her GST Exemption? Answer – the Lifetime QTIP Trust.
- What is a "Lifetime QTIP Trust"?
  - Most are familiar with the testamentary QTIP Trust which qualifies for the marital deduction; a Lifetime QTIP Trust is identical, but is created during the donor's lifetime.
  - Same rules apply under §2523(f).
  - donee spouse must be the sole beneficiary during the donee spouse's lifetime – must receive mandatory income and can receive discretionary principal.
  - Upon donee spouse's death, the Lifetime QTIP Trust is includible in her/his gross estate under §2044.

Introduction

- 5 distinct planning advantages for the Lifetime QTIP Trust:
  - Better or full utilization of the Less Affluent Spouse's Exclusions.
  - Ability to pass more property free of transfer taxes to his/her lower generations.
  - Even more property can pass free of transfer taxes to the lower generations through grantor trust status.
  - Enhanced creditor protection is available to both spouses.
  - Most importantly, the More Affluent Spouse can retain virtual control over the assets without adverse transfer tax or creditor consequences.

History and Understanding of the Transfer Tax Issues

- Example – In 2024, a decedent, D, dying as a resident of State X with a gross estate of $27,220,000.
  - D did not use any of his AEA during his lifetime, and State X imposes a flat 12% tax rate on assets in excess of its $5,000,000 exemption.
  - Assuming that all of D’s assets are subject to the State X estate tax, the State X estate tax is $1,968,000.
  - For this purpose, the only deduction from the Gross Estate is the state estate tax (which is deductible under § 2058).
  - After applying D’s then AEA of $13,610,000, D’s federal estate tax is $5,444,000.

History and Understanding of the Transfer Tax Issues

- Example (cont.).
  - Combining the two estate taxes and dividing that by the amount of D's gross estate, D's overall effective combined estate tax rate is 27.23%.
  - If D lived in a state that did not impose a separate estate tax, D's overall effective estate tax rate is only 20%. For the portion of the Gross Estate in excess of both the state exemption and the AEA, such property is taxed at a marginal combined estate tax rate of 47.2%.

History and Understanding of the Transfer Tax Issues

- Peripheral Issues
  - Byrd Rule and Reconciliation – on 1/1/26, Exemptions fall back to 2011 inflationary adjusted levels (estimated to be $7,250,000).
  - How, then, do you use the exemption now?

History and Understanding of the Transfer Tax Issues

- Spouses with Disparate Wealth
  - Consider the scenario where a married couple has a drastic disparity in wealth – one spouse holds almost all of the couple's combined wealth and such wealth exceeds the wealth holder's Exclusions.
  - This situation might arise when neither the More Affluent Spouse nor the Less Affluent Spouse have used their respective Exclusions and now there is a concern about the 2026 roll back, or the More Affluent Spouse has already used his or her Exclusions but the Less Affluent Spouse's Exclusions remain unused.

History and Understanding of the Transfer Tax Issues

- Spouses with Disparate Wealth
  - Often this occurs when the More Affluent Spouse has remarried and the newer spouse has his or her full allotment of Exemptions because he or she was never in a financial condition to consider utilizing them.
  - In each of the above scenarios, the More Affluent Spouse realizes that, instead of wasting the Less Affluent Spouse's Exemptions, perhaps they could be put to use by transferring some of the More Affluent Spouse's wealth to his or her descendants.
  - A frequent objective is for the More Affluent Spouse to retain benefits and control over the gifts while still benefiting the succeeding generations.
  - To achieve this result, all roads lead to the More Affluent Spouse creating a trust for this purpose.

Using the Less Affluent Spouse's Exclusions – Fact Pattern

- DeDe, the first wife of Jay, died in 2004. At the time of her death, DeDe was the More Affluent Spouse ("MAS")
- Jay has two children by DeDe, Mitchell and Claire, and no future children are expected. Jay married Gloria, the Less Affluent Spouse ("LAS") in 2008.
- Gloria has no children and $500,000 in assets.
- Jay has $50,000,000 in assets and would like to use Gloria's Exclusions for the benefit of Mitchell and Claire.
- Jay understands portability, but he is focused on using Gloria's Exclusions while the New Exclusion Amount is available, and to do so by funding lifetime GST trusts for his descendants (the "Descendants GST Trust").

Using the Less Affluent Spouse's Exclusions – "Split-Gift Plan"

- The easiest way to utilize a spouse's Exclusions is to engage in gift-splitting.
- Under this approach, assuming that the Jay has not already used his Exclusions, he could create the Descendants GST Trust and transfer $27,220,000 of his assets into it.
- The plan depends on Gloria agreeing to split the gifts (the "Split-Gift Plan").
- Assuming that Gloria agrees to make a split-gift election, she will be deemed to be the transferor of one-half of the assets for gift, estate and GST tax purposes.
- The deemed gift will use both of Gloria's $13,610,000 AEA and her $13,610,000 GST Exemption.

Using the Less Affluent Spouse's Exclusions – "Split-Gift Plan"

- This may be uncomfortable for Jay, as much can occur over that time period. For example, what if the marriage begins to sour and Gloria files for divorce by December 2024. Gloria is not required to consent to split the gift, so, without the election, Jay would owe gift taxes of $5,444,000 (($27,220,000 - $13,610,000 for Jay's AEA) x 40%)!

Using the Less Affluent Spouse's Exclusions – "Split-Gift Plan"

- To protect Jay from this concern, he and Gloria could enter into a post-nuptial agreement prior to effecting the gifts to the Descendants GST Trust, requiring Gloria could agree to be required to consent to the split-gift election for all of Jay's 2024 gifts.
- Issues with this: what consideration Jay would have to provide for Gloria's agreement, and the associated legal fees.

Using the Less Affluent Spouse's Exclusions – "Split-Gift Plan"

- Control Issues
  - With the Split-Gift Plan, Jay is in complete control of the Descendants GST Trust's design. He need not grant Gloria any control over the assets or the trust.
  - For example, Gloria is not required to be a beneficiary of the Descendants GST Trust, or a trustee or investment manager of the trust.

Using the Less Affluent Spouse's Exclusions – "Split-Gift Plan"

- Creditor Issues
  - Assuming that the trust contains a spendthrift clause (or the law of the particular jurisdiction automatically imposes spendthrift protection to third party trusts), the assets transferred to trust would never be exposed to Gloria's creditors, because the fiction that he is a transferor of property is only for federal transfer tax purposes.
  - The assets funding the Descendants GST Trust should also be protected from Jay's creditors because he has no beneficial interest in the trust (unless his transfers to the trust are deemed to violate his state's fraudulent or voidable transfer laws.

Using the Less Affluent Spouse's Exclusions – "Split-Gift Plan"

- Grantor Trust
  - As an extra bonus to this plan, the Descendants GST Trust is designed as a grantor trust for income tax purposes.
  - Because the split-gift election is only a transfer tax fiction created under the Code, it does not apply for income tax purposes.
  - As a result, Jay is the grantor of the entire trust for income tax purposes.

Using the Less Affluent Spouse's Exclusions – "Split-Gift Plan"

- Step-Transaction Doctrine Issues
  - A concern in any multi-step planning technique is the threat that the IRS may attempt to undo the transaction by applying the step-transaction doctrine (the "Step-Transaction Doctrine").
  - Usually, the Step-Transaction Doctrine is invoked when, for example, a taxpayer intends for a preferential tax result, but cannot achieve the result on his or her own.
  - Instead, the taxpayer must undertake several steps to be taken not only by him or her, but by others.
  - Not an issue with the Split-Gift Plan because the Step-Transaction Doctrine is not applicable to gift-splitting – the actions by the spouse in electing to split the gift are statutorily granted to the spouse.

Using the Less Affluent Spouse's Exclusions – "Split-Gift Plan"

- Psychological Effect to MAS of the Permanent Divesture of Assets
  - Creating a trust to benefit Jay's descendants causes the total divestiture of the transferred assets from him, meaning that he forever loses the use and benefit of the $27,220,000.
  - For many clients, even if they have sufficient other assets whereby the gifts would not affect the client's standard of living, the thought of forever transferring $27,220,000 is concerning, even if the risk is merely perceivable and not actual.

Using the Less Affluent Spouse's Exclusions – "Marital Gift/Re-Gift Plan"

- Regardless of whether Jay has any portion, or all, of his Exclusions available, another option is for Jay to give Gloria $13,610,000 of assets and then, at some point in the future, Gloria gifts $13,610,000 to the Descendants GST Trust, or creates a new Descendants GST Trust that only benefits Jay's descendants (the "Marital Gift/Re-Gift Plan").
- For many clients, this seems to be the most logical – and easiest – approach, as it would avoid the delay in confirming the split-gift.

Using the Less Affluent Spouse's Exclusions – "Marital Gift/Re-Gift Plan"

- Estate, Gift and GST Tax Implications to Gloria
  - Following Jay's gift to Gloria, she becomes the owner of the assets.
  - Presumably, this approach envisions that Gloria will be vested with full fee ownership. As such, she would become the transferor of the assets for all purposes.
  - Upon Gloria's subsequent gift to the Descendants GST Trust, Gloria will be the transferor of the assets for income, gift, estate and GST tax purposes.

Using the Less Affluent Spouse's Exclusions – "Marital Gift/Re-Gift Plan"

- Control Issues
  - With the Marital Gift/Re-Gift Plan, Jay can still be in complete control of the design of the Descendants GST Trust.
  - Similar to the Split-Gift Plan, Jay does not need to grant any interest or control to Gloria in the trust. However, following Jay's gift to Gloria, the assets are exposed to Gloria's control and she – and she alone - decides whether to give property to the Descendants GST Trust.
  - This plan also raises marital law implications - as an inter-spousal gift, it would likely convert the property from Jay's separate property to marital property or perhaps to Gloria's separate property.

Using the Less Affluent Spouse's Exclusions – "Marital Gift/Re-Gift Plan"

- Grantor Trust
  - Gloria, and not Jay, is the grantor for income tax purposes of the portion of the Descendants GST Trust represented by Gloria's contribution to the trust or of the separate Descendants GST Trust created by Gloria.
  - This approach is not ideal because Jay has the wealth from which to pay the income taxes, and it would be preferable to have Gloria completely removed from the plan once her Exclusions are used.
  - Assuming that Jay and Gloria remain married, this does not pose that much of an inconvenience if they elect "Married Filing Jointly" status for their income tax returns.

Using the Less Affluent Spouse's Exclusions – "Marital Gift/Re-Gift Plan"

- Grantor Trust
  - However, should they divorce, the grantor trust status for Gloria becomes more problematic.
  - Gloria has no individual funds from which to pay the taxes. Therefore, assuming that the trust contains an "income tax reimbursement clause," either the trustee would have to exercise the authority and pay to Gloria the income taxes owed on her share (and thereby reducing the exponential compounding associated with grantor trust status), or Jay would have to pay the income taxes by making annual and/or taxable gifts to Gloria (which is also the only solution if the trust does not contain an income tax reimbursement clause).

Using the Less Affluent Spouse's Exclusions – "Marital Gift/Re-Gift Plan"

- Grantor Trust
  - NOTE: Florida has a statute – Fla. Stat. §736.08145 - that allows for reimbursement regardless of whether the trust contains a reimbursement clause.

Using the Less Affluent Spouse's Exclusions – "Marital Gift/Re-Gift Plan"

- Grantor Trust
  - Even absent a divorce, if the objectives are to utilize Gloria's Exclusions and not have her involved in any other aspect of the plan, the second objective would fail because, as a grantor trust, Gloria would receive the trust's 1099s reporting the trust's taxable income.
  - Even without a divorce, the plan is hampered if Gloria were to predecease Jay, as Gloria's death terminates the grantor trust status of Gloria's portion of the trust and the trust is bifurcated for federal income tax purposes and the joint filing status no longer prevents this result.

Using the Less Affluent Spouse's Exclusions – "Marital Gift/Re-Gift Plan"

- Step-Transaction Doctrine Issues
  - The Marital Gift/Re-Gift Plan is almost a textbook example of the Step-Transaction Doctrine.
  - It would appear as if the IRS would not have much difficulty in applying the Step-Transaction Doctrine to this technique by arguing that the use of Gloria's Exclusions is the result of a prearranged plan between Jay and Gloria and that the gift to Gloria is a sham and should be ignored — i.e., that Jay, and not Gloria, is the real donor of the assets to the trust for Jay's descendants.
  - What if Gloria instead creates a SLAT for Jay? Step-Transaction is still a possibility, but advantages to both can temper some of the arguments.

Using the Less Affluent Spouse's Exclusions – "Lifetime QTIP Trust Plan"

- The third option does not involve outright gifts to the Less Wealthy Spouse and nor does it involve much dependency on elections by the LAS, and yet it accomplishes all of the intended goals of the MAS – this is the "Lifetime QTIP Trust Plan."
- The Lifetime QTIP Trust is used to establish a controlled plan to use Gloria's Exclusions during her lifetime or upon her death while still affording Jay the control and access that he desires.

Using the Less Affluent Spouse's Exclusions – "Lifetime QTIP Trust Plan"

- The Plan
  - The Lifetime QTIP Trust Plan begins with Jay funding a Lifetime QTIP Trust with $13,610,000 – i.e., the amount equal to Gloria's Exclusions. So far, nothing out of the ordinary.
  - On the 709, normally, with a Lifetime QTIP Trust, the settlor makes the "Reverse-QTIP Election" under §2652(a)(1); with this plan, this DOES NOT OCCUR because Jay WANTS Gloria to be the transferor for GST purposes upon his death or earlier release.
  - A benefit of this approach is that it scalable to either of the Exclusions or both – using a fractional or formula QTIP election to utilize the Reverse-QTIP Election.

Using the Less Affluent Spouse's Exclusions – "Lifetime QTIP Trust Plan"

- Gift, Estate and GST Tax Implications to Gloria
  - As a QTIP trust, upon Gloria's death, the value of the trust would be included in her Gross Estate under § 2044 and she would become the transferor of the trust's assets for GST tax purposes (this is the effect of Jay's not having made the Reverse-QTIP Election). As such, Gloria's Exclusions would be used upon her death.

Using the Less Affluent Spouse's Exclusions – "Lifetime QTIP Trust Plan"

- Gift, Estate and GST Tax Implications to Gloria
  - Alternatively, at some point after the Lifetime QTIP Trust is funded, Gloria could *release* her interests.
  - If Gloria entirely releases her interests in the Lifetime QTIP Trust, she would be treated as having made a gift of 100% of the QTIP property because the release would trigger a gift of her income interest under § 2511 and the entire value of the remainder interest under § 2519.
  - The gifts triggered by the release would consume Gloria's AEA and permit her GST Exemption to be allocated to the Lifetime QTIP Trust.
  - The Lifetime QTIP Trust would then become the Descendants GST Trust for Jay's descendants.

Using the Less Affluent Spouse's Exclusions – "Lifetime QTIP Trust Plan"

- Gift, Estate and GST Tax Implications to Gloria
  - Can Gloria somehow disrupt the plan? Suppose that at her death she specifically instructs her executors to NOT allocate her GST exemption.
  - Based on the literal provisions of § 2632(c)(5), even if her executors wanted to "opt out," they would be prohibited from doing so because § 2632(c)(5)(B) provides that any election to "opt out" must be contained in a 709, and since this is at Gloria's death, the transfer is reported on her 706 and not a 709, so the "opt out" is not possible.
  - This is an issue with a release, so to prevent this result, a nuptial agreement is recommended.

Using the Less Affluent Spouse's Exclusions – "Lifetime QTIP Trust Plan"

- Control Issues
  - The Lifetime QTIP Trust Plan allows Jay's design of the Lifetime QTIP Trust to control the management and disposition of the assets at all times.
  - Other than her income interest, Gloria has only one other influence over the trust, which is to decide whether to release her interests in the trust during her lifetime thereby triggering the transfer tax.
  - Nevertheless, on Gloria's death or release of her trust interest, the principal passes to the Descendants GST Trust, so Jay will have succeeded in transferring the wealth downward for the benefit of his descendants

Using the Less Affluent Spouse's Exclusions – "Lifetime QTIP Trust Plan"

- Creditor Protection
  - The assets transferred to the Lifetime QTIP Trust can be protected from Gloria's creditors by structuring the trust as a spendthrift trust.
  - The assets funding the Lifetime QTIP Trust should also be protected from Jay's creditors if the transfer to the trust is not a fraudulent/voidable transfer because he has no interest in the trust

Using the Less Affluent Spouse's Exclusions – "Lifetime QTIP Trust Plan"

- Grantor Trust
  - As a QTIP Trust or as a Descendants Trust if Gloria releases her interest, the trust(s) remain a grantor trust as to Jay
  - The income tax treatment as to Jay is completely independent of the transfer tax treatment; Jay remains the grantor of any continuing trust for his children's benefit under the grantor trust rules, even though Gloria's release of her interests in the Lifetime QTIP Trust makes her the transferor for gift and GST tax purposes.

Using the Less Affluent Spouse's Exclusions – "Lifetime QTIP Trust Plan"

- Grantor Trust
  - This result is reliant upon the language of Treas. Reg. §1.671-2(e)(5), which provides:

    If a trust makes a gratuitous transfer of property to another trust, the grantor of the transferor trust generally will be treated as the grantor of the transferee trust. However, if a person ***with a general power of appointment over the transferor trust*** exercises that power in favor of another trust, then such person will be treated as the grantor of the transferee trust, even if the grantor of the transferor trust is treated as the owner of the transferor trust under subpart E of the Internal Revenue Code. (emphasis added.)

Using the Less Affluent Spouse's Exclusions – "Lifetime QTIP Trust Plan"

- Grantor Trust
  - Pursuant to this Regulation, a change in grantor for income tax purposes occurs only if someone possesses a general power of appointment over the transferor trust and actually exercises it in favor of another trust.
  - In the example above, Gloria would not hold a general power of appointment over the Lifetime QTIP Trust and therefore Jay will remain the grantor of the trust for income tax purposes after Gloria's release of her interests in the trust.

Using the Less Affluent Spouse's Exclusions – "Lifetime QTIP Trust Plan"

- Step-Transaction Doctrine Issues
  - If Jay creates the Lifetime QTIP Trust and Gloria immediately releases her interest in the trust, the IRS might argue that this was part of a pre-conceived plan.
  - The good news is that, in §2523(f)(1)(B), the Code provides a defense in connection with a Lifetime QTIP Trust, which provides "for purposes of subsection (b)(1), no part of such property shall be considered as retained in the donor or transferred to any person other than the donee spouse."
  - Thus, with respect to a transfer to a Lifetime QTIP Trust, Jay has not retained an interest in the trust and it is implausible for the Step-Transaction Doctrine to be applied because the Code clearly states otherwise.

Using the Less Affluent Spouse's Exclusions – "Lifetime QTIP Trust Plan"

- Plan Enhancement - Returning Trust for Jay
  - Why not provide for a "back end" interest for Jay after Gloria's interest terminated?
  - This would be a self-settled spendthrift trust issue, for which Nevada has the de facto protection for self-settled spendhtift trusts.
  - Several other jurisdictions have protection for QTIP trusts with a back-end interest for the donor spouse – for example, see Fla. Stat. §736.0505(3).
  - The protection, however, may not arise upon a release. Michigan and Maryland's QTIP Statutes are the only ones that appear to protect the donor spoue's interest upon a release.

Part II– An Oxymoron? The Deathbed Lifetime QTIP for Basis Adjustment and Asset Protection

Introduction

- "Deathbed" estate planning is one concept that has always piqued the interest of estate planners. For the most part, death is one of the few great unknowns of the human existence – no one truly knows when one will die.

Foundation for the Plan – an Introduction to Important Concepts

- Income Taxation of Deathbed Transfers
  - Pre-1982 Deathbed Transfer Tax Advantages
  - 1982 and the adoption of §1014(e)
- Self-Settled Spendthrift Trusts
  - Pre-1997 Asset Protection
  - 1997 and the Advent of the Self-Settled Spendthrift Trust
  - Anatomy of a Standard DAPT
  - DAPTs and the Third Party Trust– "Quasi-DAPTs"

Deathbed Lifetime QTIP Trust Strategy – An Overview

- Example Facts
  - As of January 1, 2024, Claire and Phil, Florida residents, are in their first marriage and are ages 75 and 80, respectively.
  - They each have a revocable trust funded (for over 1 year) with $15 million of assets all having a zero basis for income tax purposes in which no portion of the potential gain is income in respect of a decedent.
  - Upon the diagnosis of Phil's terminal condition, Claire quickly establishes a Lifetime QTIP Trust for Phil's benefit and funds it with $13,610,000 of assets from her revocable trust
  - Claire timely files a Form 709 and elects, pursuant to §2523(f), to qualify the entire Lifetime QTIP Trust for the federal gift tax marital deduction.

Deathbed Lifetime QTIP Trust Strategy – An Overview

- The Lifetime QTIP Trust provides that, upon Phil's death, the balance of the trust assets is to be held in a discretionary Resulting Trust for Claire and Claire's descendants.
- With Phil's available AEA having been allocated against the Resulting Trust, the formula provision in Phil's revocable trust passes the balance of Phil's assets to a standard testamentary QTIP trust for Claire's benefit.

General Effect of the Strategy

- Claire's transfer of a minimum of $13,610,000 into a Lifetime QTIP Trust is intended to be taxed in Phil's gross estate in order to create a Resulting Trust utilizing both of Phil's AEA and his available GST tax exemption under §2631.
- Assuming that Claire only transferred the $13,610,000 into the Lifetime QTIP Trust, the Resulting Trust becomes a "bypass trust"
- In addition, the bypass trust is also a "grantor trust" for federal income tax purposes.
- Because the Lifetime QTIP Trust was included in Phil's gross estate under §2044, Treas. Reg. §25.2523(f)-1(f), Examples 10 and 11 provide that the bypass Resulting Trust will *not* be included in Claire's gross estate pursuant to §2036 or §2038 even though Claire's beneficial interest in the Resulting Trust is technically a retained interest.

Income Tax Analysis

- Generally, if QTIP property is included in a spouse’s gross estate pursuant to §2044, then, pursuant to §1014(b)(10), the QTIP property is considered to have been “acquired from or to have passed from” that spouse, which triggers the General Basis Adjustment Rule for the QTIP property.
- As for QTIP property held in trust, at the moment of the decedent’s death, such property is treated, for income tax purposes, as owned by the donor spouse.

Income Tax Analysis

- If Rev. Rul. 85-13 stands for the premise that, for "grantor trust" purposes, the grantor (i.e., Claire) "owns" the property, then, under §1014, does "grantor trust" property actually "pass" from a decedent (i.e., Phil) since the decedent is not treated as "owning" the property for income tax purposes?
- No - the phrase "acquiring the property from a decedent" in §1014(a) is explained in §1014(b), which appears to refer to the actual transfer of property and not to the "income tax" transfer of property.

Income Tax Analysis

- Effects of the One-Year Rule
  - Under §1014(e), there is no basis adjustment for property transferred to the decedent within one year of the decedent's death and which is then bequeathed back to the transferor.
  - The statute refers to property re-acquired by the "donor" of the property - who exactly is the "donor" in this instance?

Income Tax Analysis

- Effects of the One-Year Rule
  - The Lifetime QTIP Trust assets will be included in Phil's gross estate pursuant to §2044. The remainder, however, is not returning directly to Claire, but, rather, is returning *indirectly* to Claire in the form of a current interest in a trust (or trusts).
  - The legislative history to §1014(e) appears to provide for a far more expansive reach than the statutory language – uses the phrase *directly or indirectly*

Income Tax Analysis

- Effects of the One-Year Rule
  - A narrow interpretation is that “indirectly” refers to transfers in trust where the funds will ultimately be distributed outright to the donor
  - A broader application is that “indirectly” could include a mandatory or discretionary income interest in a trust
  - If the broader interpretation is applied, the General Basis Adjustment Rule would not apply to the entire Resulting Trust for Claire
  - Only guidance is 5 published Private Letter Rulings in which §1014(e) was a primary focus, and, in each such ruling, the Service relied on the “direct or indirect” language from the legislative history in interpreting the scope of §1014(e).

Income Tax Analysis

- Effects of the One-Year Rule
  - If the donor spouse does not necessarily need full access to the funds, the Resulting Trust should be prepared as a discretionary trust under which the distribution of income and principal is at the complete discretion of independent trustees.
  - Drawn in this manner, it would appear impossible to actuarially determine the "definite" interest in the donor spouse.
  - Bifurcation Rule – if the donor spouse must have access to some of the funds - not enough access to require an outright payment of all assets back to the donor spouse, but partial access by means of a mandatory income interest.

Income Tax Analysis

- Effects of the One-Year Rule
  - Under the PLRs, the suggestion is made that §1014(e) would apply to any portion of assets in trust where the donor spouse has a definite interest, such as a mandatory income interest.
  - Under that scenario, the PLRs infer that §1014(a) and §1014(e) would apply proportionately between the determinable interest for the spouse (i.e., the mandatory income interest) and the other interests in the trust.

Income Tax Analysis

- Continuing Grantor Trust Status for Resulting Trusts
  - If, upon a spouse's death, the testamentary documents provide for a bypass trust, the bypass trust is its own taxpayer for income tax purposes.
  - Under the Deathbed QTIP, the Resulting Trust (or Trusts) can be structured to be grantor trusts as to the donor spouse - Treas. Reg. §1.671-2(e)(5).

Creditor Protection Analysis

- Creditor Protection During Phil's Lifetime
  - As described above, the Lifetime QTIP Trust is an irrevocable trust under which Claire, as the settlor, has not retained any current interests.
  - For the duration of Phil's lifetime, Phil is the sole current recipient of trust income and, depending on the trust provisions, will be the sole recipient of discretionary principal distributions.
  - Assuming a spendthrift clause is included, the trust is asset protected as to both Phil and Claire.

Creditor Protection Analysis

- Phil's Death – Protection for Claire
  - Where the Deathbed Strategy deviates from the norm is upon Phil's death.
  - At first glance, once the Resulting Trust is created, Claire, who created the Lifetime QTIP Trust, now has a beneficial interest in a trust created under the Lifetime QTIP Trust.
  - In other words, the Resulting Trust is technically a DAPT for Claire's benefit and most states (other than Nevada) do not provide creditor protection for such self-settled interests.
  - As the objective is to provide creditor protection for Claire, the Lifetime QTIP Trust must be established in either a DAPT State or a Quasi-DAPT State (like Florida).
  - Further, there is NO One-Year Rule Equivalent

Creditor Protection Analysis

- Phil's Death – Protection for Claire (cont.)
  - The asset protection feature of the Quasi-DAPT Statutes is applicable so long as the donor spouse makes a timely and proper gift tax QTIP election – otherwise, the QTIP election would not be in place.
  - No Effect on Grantor Trust Statute- it is important to acknowledge that, while a Quasi-DAPT Statute "switches" the settlor for state law purposes only, such statutes have no effect on "grantor trust" status for federal income tax purposes.

Creditor Protection Analysis

- Negating a §2041 Argument
  - Treas. Reg. §25.2523(f)-1(f), Examples 10 and 11 provide clear guidance that the Resulting Trust established as a bypass trust for Claire's lifetime is not included in Claire's gross estate upon her death under §2036 and §2038.
  - However, because the Resulting Trust is created under a trust document created by Claire, and because the Resulting Trust benefits Claire, the Resulting Trust is technically a DAPT as to Claire, which means that Claire's creditors can potentially reach a portion (or all) of the Resulting Trust.
  - If Claire's creditors can reach a portion of a Resulting Trust, would that portion then be includible in Claire's gross estate under §2041?

Creditor Protection Analysis

- Negating a §2041 Argument (cont.)
  - If the Resulting Trust is established the in either a DAPT State or a Quasi-DAPT State, then the Settlor's creditors cannot reach the Resulting Trust, so there should be no potential §2041 gross estate inclusion of the Resulting Trust.

Creditor Protection Analysis

- Interaction with Applicable Fraudulent/ Voidable Statutes
  - The transfer to the QTIP may not be in violation of the particular state's fraudulent transfer laws
  - The Deathbed Strategy involves taking advantage of the creditor protection laws of either a DAPT State or a Quasi-DAPT State, thereby presenting a definite and acknowledged asset protection element to the transaction.
  - Is the "asset protection" intent enough to signify the "actual" intent needed to invoke fraudulent transfer law?
  - The creditor issue is further enhanced if a state adopts the UVTA and its courts apply the new Comments issued as part of the UVTA to the application of its UVTA law.

Creditor Protection Analysis

- Interaction with Applicable Fraudulent/ Voidable Statutes (cont.)
  - Courtesy of §10 and the Comments to §4 and §10, if Phil and Claire are not residents of either a DAPT state or a Quasi-DAPT State, the ability to implement the Deathbed Strategy may be hampered.

INTER-VIVOS QTIP TRUST PLANNING STRATEGIES: THE PERFECT (“BEST”) APPROACH TO USING YOUR SPOUSE’S APPLICABLE EXCLUSION AMOUNT AND GST EXEMPTION AND PLANNING WITH A LIFETIME “DEATHBED” TRUST

California Lawyers Association
Taxation Section

2024 Estate and Gift Tax Conference

March 21, 2024

San Francisco, California

<u>Presented By:</u>

GEORGE D. KARIBJANIAN
Franklin Karibjanian & Law, PLLC
gkaribjanian@fkl-law.com

<u>Boca Raton Office:</u>
150 E. Palmetto Park Road, Suite 800
Boca Raton, Florida 33432
Direct Dial: (561) 208-1272

<u>Washington, DC Office:</u>
1101 17th Street, N.W., Suite 820
Washington, DC 20036
Direct Dial: (202) 495-2676

FRANKLIN KARIBJANIAN & LAW, PLLC
GEORGE D. KARIBJANIAN

George D. Karibjanian
Fellow, American College of Trust and Estate Counsel
Board Certified By The Florida Bar in Wills, Trusts and Estates
Admitted in Florida, D.C. and Virginia

FRANKLIN KARIBJANIAN & LAW, PLLC
150 E. Palmetto Park Road, Suite 800
Boca Raton, Florida 33432

1101 Seventeenth Street, N.W., Suite 820
Washington, DC 20036

Direct: (202) 495-2676
Fax: (202) 463-3060
----
gkaribjanian@fkl-law.com
www.fkl-law.com

George D. Karibjanian is a Founding Member of Franklin Karibjanian & Law, a national boutique law firm based in Washington, D.C., with additional offices in Boca Raton, Florida and Naples, Florida. George is Board Certified by the Florida Bar in Wills, Trusts & Estates and is a Fellow in the American College of Trust and Estate Counsel.

George divides his time between the Boca Raton and Washington offices, spending the majority of his time in Boca Raton.

He earned his B.B.A. in Accounting from the University of Notre Dame in 1984, his J.D. from the Villanova University School of Law in 1987, and his LL.M. in Taxation from the University of Florida in 1988. George has practiced his entire legal career in South Florida (over 35 years), practicing exclusively in the areas of estate planning and probate and trust administration, and also represents numerous clients with respect to nuptial agreements. George has participated in over 225 formal presentations, either individually or as part of a panel discussion, to national, state-wide and local groups, and has over 80 publication credits in national and regional periodicals and journals. Born and raised in Vineland, New Jersey (in the heart of South Jersey), George has called Boca Raton home since 1988.

On the topic of the Uniform Voidable Transactions Act and its potential negative effect on estate planning, George has published several articles and has lectured in cities across the nation such as San Diego, Las Vegas, Portland (Or.) and New York, presented webinars to groups in South Dakota and Alaska, and has presented on the topic in October 2016 at the 42nd Annual Notre Dame Tax and Estate Planning Institute in South Bend, Indiana.

On the topic of same-sex estate planning, George has lectured at various conferences and estate planning councils throughout the United States and has published numerous articles in publications such as Steve Leimberg's LISI Estate Planning Newsletters, Trusts & Estates Magazine and the Florida Bar Journal. George has also been quoted by several publications and websites.

On January 15, 2014, George was presenter at the 48th Annual Heckerling Institute on Estate Planning in Orlando, Florida, speaking on a panel discussion titled, "Living and Working with the Uniform Principal and Income Act," focusing on the tax effects on the power to adjust trust principal to income, the power to convert an income trust to a unitrust, comparing the various unitrust statues and focusing on potential litigation facing fiduciaries in this area.

George's other lectures have included topics such as Portability, Decanting, Trustee Selection and Duties, the Principal and Income Act, Current Developments in Estate Planning and Taxation, Representing a Client with Potential Capacity Issues, Whether a Supplemental 706 is Required, Inter-Vivos QTIP Planning and Prenuptial Agreements for the Estate Planner and the Advantages and Disadvantages of Domestic Asset Protection Trusts.

For the American Bar Association's Section of Taxation, he is the most recent Past Co-Chair of the Estate and Gift Tax Committee; was the Chairperson for the Section's 2016 Comments on the Basis Consistency Regulations, the Chairperson for a 2011-12 Section Task Force Subcommittee Advocating Changes to the Portability Provisions Added by the 2010 Tax Act; and a contributing draftsman to the Section's 2012 Comments on decanting.

For the American Bar Association's Section of Real Property Trusts & Estates, he is a current Co-Chair of the Estate and Gift Tax Committee within the Section's Income and Transfer Tax Planning Group and is a member of the CLE Committee.

For the Florida Bar's Real Property Probate & Trust Law Section, he is a Past Chair for the Section's Asset Protection Committee; has been the Co-Vice Chair – Probate & Trust and National Events Editor for the Section's "ActionLine" publication since 2012; the Co-Chairperson of the RPPTL Ad Hoc Committee regarding potential statutory changes in light of a change in Florida's DOMA laws; a member of the Ad Hoc committee to study changes to Florida's decanting statutes; the Chairperson and primary draftsman of the Section's 2012 comments to the IRS on decanting, a member of the RPPTL Ad Hoc Committee that drafted a statutory change in response to Florida's Morey v. Everbank decision; and a current member to the Section's Executive Council.

George is also a member of the Greater Boca Raton Estate Planning Council and the South Palm Beach County Bar Association.

George currently serves on the Professional Advisory Committee for George Snow Memorial Scholarship Foundation. Previously, George served on the Professional Advisory Committee for the Boca Raton Museum of Art from 2011 to 2019 and served on the Board of Directors for the Palm Beach County Wealth & Estate Planning Seminar from January 2015 until its suspension in January 2019. George also served as President and a member of the Board of Directors of the Notre Dame Alumni Club of Boca Raton (1996-1997), a member of the St. Jude's Church (Boca Raton) Financial Education Council (1994-1996), and Vice President and a member of the Board of Directors of the Boca Raton Girls Fastpitch Softball Association (2004-2008).

TABLE OF CONTENTS

INTER-VIVOS QTIP TRUST PLANNING STRATEGIES: THE PERFECT ("BEST") APPROACH TO USING YOUR SPOUSE'S APPLICABLE EXCLUSION AMOUNT AND GST EXEMPTION AND PLANNING WITH A LIFETIME "DEATHBED" TRUST

George D. Karibjanian[1]

I. The Lifetime QTIP Trust – The Perfect ("Best") Approach to Using Your Spouse's Applicable Exclusion Amount and GST Exemption

A. Introduction

(1) As part of the 2017 Tax Cuts and Jobs Act (the "2017 Act"), each individual's estate and gift tax exemption, otherwise known as the "basic exclusion amount" or "BEA",[2] as well as the exemption from the generation-skipping transfer ("GST") tax (such exemption is referred to as the "GST Exemption"),[3] was doubled.

(a) Based on the required annual inflationary adjustment calculations, in 2021, each individual has a BEA of $11,700,000 and a GST Exemption of $11,700,000 (collectively, the BEA and the GST Exemption may be referred to as the "Exclusions").[4]

(b) The Exclusions will continue to be increased annually for inflationary purposes until 2026, when they return to the 2011 threshold of $5,000,000 with annual inflationary adjustments (which, in 2026, is estimated to be approximately $6,000,000[5] for a single person or $12,000,000 for a married couple).

(c) During the 2020 election and in some legislation proposed in early 2021, the Exclusions could be reduced as soon as 2022.[6]

(2) Prior to the 2017 Act, it was estimated that 99.8% of the United States population would not be required to file a U.S. Estate (and Generation-Skipping Transfer) Tax Return, Form 706 (a "706"), and, with the doubling of the Exclusions, this threshold is likely increased to 99.9%.

(a) These statistics quantify that, of the entire United States population, only 0.1% of the population has a gross estate for federal estate tax purposes (the "Gross Estate") in excess of $11,400,000 (which is the current filing threshold for a 706).[7] Let that sink in for a moment – only 1 out of every 1000 individuals will be required to file a 706.

---

[1] ©2024 by George D. Karibjanian. All rights reserved.

[2] Section 2010(c)(5) of the Internal Revenue Code of 1986, as amended (the "Code"). For all purposes of this Outline, unless otherwise specified, section references shall be to the Code.

[3] Section 2631(b).

[4] The BEA is one component of the "applicable exclusion amount", or "AEA". Each individual's AEA may be higher if the individual has received any deceased spousal exclusion amount from his or her most recently predeceased spouse. Throughout this Article, references may be to either the BEA or the AEA.

[5] The $6,000,000 amount is roughly calculated by determining what the exclusion would have been in 2026 (using the cost of living factor in effect prior to 2018) if the 2017 Act had not been enacted.

[6] For purposes of this Outline, the potential for retroactive 2021 legislation is disregarded.

[7] *See generally*, Center of Budget and Policy Priorities, *Policy Basics: The Federal Estate Tax* (November 7, 2018). According to the *Tax Policy Center, Urban Institute and Brookings Institution*, it is estimated that out of the projected 2.7 million deaths in 2018, only 1,700 decedent's estates will pay an estate tax, which translates to 99.937% of estates passing transfer tax-free.

(b) The conclusion from this analysis is that, with the passage of the 2017 Act, a major focus of estate planners is how to plan for the usage of the additional Exclusions for the 0.1% and others that could benefit from it prior to any roll back.

(3) For many wealthy married couples, the assets are concentrated in one spouse (referred to as the "More Affluent Spouse").

(a) The Less Affluent spouse (the "Less Affluent Spouse") usually owns little or no assets, which presents the distinct possibility that he or she will waste his or her Exclusions.

(b) This was one problem that portability was intended to resolve; if the Less Affluent Spouse died first, his or her unused AEA amount could pass to the More Affluent Spouse.[8]

(c) However, portability only applies to the AEA; currently, there is no portability for the GST tax.

(4) How, then, can the More Affluent Spouse not only utilize the Less Affluent Spouse's AEA, but also his or her GST Exemption? Answer – the Lifetime QTIP Trust. Considering both the current transfer tax landscape and our personal history of advocating the use of a lifetime qualified terminable interest property ("QTIP") trust (referred to as a "Lifetime QTIP Trust") in the estate plans of wealthy married couples,[9] this outline proposes that the solution to this quandary is the use of the Lifetime QTIP Trust.[10]

(5) The Lifetime QTIP Trust creates five distinct planning advantages for the More Affluent Spouse:

(a) The More Affluent Spouse can better (or, depending on the size of the estates, fully) utilize the Less Affluent Spouse's Exclusions.

(b) The More Affluent Spouse can pass more property free of transfer taxes to his/her lower generations.

(c) Even more property can pass free of transfer taxes to the lower generations through the income tax advantages of grantor trust status.

(d) Enhanced creditor protection is available to both spouses.

(e) Most importantly, the More Affluent Spouse can retain virtual control over the assets without adverse transfer tax or creditor consequences.

---

[8] Under § 2010(c)(4), the other component of the AEA, the "deceased spousal unused exclusion amount" is the lesser of the BEA or the excess of the AEA of the last such deceased spouse of such surviving spouse over the amount with respect to which the tentative tax is determined under § 2001(b)(1) on the estate of such deceased spouse. "AEA" is used above for simplicity purposes.

[9] *See* Richard S. Franklin & George D. Karibjanian, *An Oxymoron? The Deathbed Lifetime QTIP for Basis Adjustment and Asset Protection*, 41 BLOOMBERG BNA TAX MANAGEMENT'S ESTATES, GIFTS AND TRUSTS JOURNAL, No. 6, p. 219 (November/December 2016) (cited herein as "DEATHBED LIFETIME QTIP") (which is the basis for Section II of this Outline); Richard S. Franklin, *Creatively Using Lifetime and Testamentary QTIPs - A Federal and Washington Perspective*, 59TH ANNUAL ESTATE PLANNING CONFERENCE, WASHINGTON STATE BAR ASSOCIATION, Chapter Ten-A (October 2014); Barry A. Nelson & Richard S. Franklin, *Inter Vivos QTIP Trusts Could Have Unanticipated Income Tax Results to Donor Post-Divorce*, LISI ESTATE PLANNING NEWSLETTER #2244 (Sept. 15, 2014).

[10] For an in-depth analysis of Lifetime QTIP Trusts, *see* Richard S. Franklin, *Lifetime QTIPs: Why They Should be Ubiquitous in Estate Planning*, 50TH HECKERLING INSTITUTE ON ESTATE PLANNING (January 14, 2016) (published version: 50th U. MIAMI HECKERLING INST. EST. PLAN ¶ 16 (2016, U. Miami)). Hereinafter references to this article will be to "UBIQUITOUS" and using the published version's section references.

(6) As can be inferred through the description of the technique, this approach has significant appeal to wealth holders in second (or third or fourth) marriages and especially where there is a significant gap in wealth between the More Affluent Spouse and the Less Affluent Spouse.

B. History and Understanding of the Issues

(1) With tax or estate planning strategies, historical and background knowledge is extremely important for a comprehensive understanding of the particular strategy; otherwise, the planner may advise a client to engage in a transaction without appreciating the ramifications if the transaction is undone or is not properly implemented.

(2) Current Exclusion Levels and Transfer Tax Rates

(a) With respect to the actual imposition of transfer taxes, wealth in excess of the Exclusions is subject to transfer taxes at a federal rate of 40% (transfers subject to the GST tax are typically assessed at the time of a transfer subject to either estate or gift tax, or perhaps later in time in the case of a taxable distribution or termination).

(b) As stated above, the amount of the federal Exclusions is $11,700,000 for 2021, which is a $6,210,000 increase from the 2017 amounts.[11]

(c) However, in 2026 (or perhaps earlier if 2021 tax reform includes lowering the Exclusions),[12] the two Exclusions are scheduled to roll back to the pre-2018 levels. Recalling that the Democrats opposed the 2017 Act, it will be very easy for the Democrats to lower the Exclusion amounts by one of two methods – they could doing nothing all, thereby allowing the 2026 sunset to occur, or, if all Democratic and Independent Senators join together and if reconciliation is elected (see below), they can simply repeal the increased Exclusion amounts.

(d) The imposition of estate taxes is not limited to the federal government.

[11] Rev. Proc. 2018-18, Section 3.35 (March 5, 2018). *See also*, § 1602 of the 2017 Act, which doubled the BEA from $5,000,000 to $10,000,000, subject to sunset in 2026.

[12] *See e.g.*, Fred Hiatt, *It's open season on the wealthy. But not every tycoon should be flattened*, WASHINGTON POST (February 3, 2019); Aaron Blake, *Republicans call Ocasio-Cortez's and Warren's tax-the-wealthy plans 'radical.' Trump's were even more radical*, WASHINGTON POST (February 4, 2019); Jeff Stein, *'A very big experiment:' How Elizabeth Warren would try forcing billionaires to pay her wealth tax*, WASHINGTON POST (February 4, 2019); Helaine Olen, *How Donald Trump is helping Democrats to call for tax increases*, WASHINGTON POST (February 4, 2019); Steven Pearlstein, *Wealth tax. 70 percent rates. Medicare-for-all. Let's take a breath.*, WASHINGTON POST (February 5, 2019); Christopher Ingraham, *Over 60 percent of voters – including half of Republicans – support Elizabeth Warren's wealth tax*, WASHINGTON POST (February 5, 2019); Christopher Ingraham, *People like the estate tax a whole lot more when they learn how wealth is distributed*, WASHINGTON POST (February 6, 2019); Damian Paletta, and Jeff Stein, *Billionaires strike back as Democrats embrace higher taxes, economic populism*, WASHINGTON POST (February 6, 2019).

(i) At the state level, twelve states and the District of Columbia[13] impose their own separate estate taxes at varying rates with varying exemptions.

(ii) For example, the Maryland estate tax is imposed at a flat 16% for estate property in excess of its $5,000,000 exemption.[14]

(iii) Although a deduction is allowed at the federal level for the payment of state estate taxes,[15] this will still result in a higher overall estate tax rate.

(A) Consider the following example from 2019 of a decedent, D, dying as a resident of State X with a gross estate of $21,400,000.

(B) D did not use any of his AEA during his lifetime, and State X imposes a flat 12% tax rate on assets in excess of its $5,000,000 exemption.

(C) Assuming that all of D's assets are subject to the State X estate tax, the State X estate tax is $1,968,000.

(D) For this purpose, the only deduction from the Gross Estate is the state estate tax (which is deductible under § 2058).

(E) After applying D's then AEA of $11,400,000, D's federal estate tax is $3,212,800. Combining the two estate taxes and dividing that by the amount of D's gross estate, D's overall effective combined estate tax rate is 24.21%. If D lived in a state that did not impose a separate estate tax, D's overall effective estate tax rate is only 15.01%. For the portion of the Gross Estate in excess of both the state exemption and the AEA, such property is taxed at a marginal combined estate tax rate of 47.2%.

(3) Seeing the Sunset … Again

(a) A long, long time ago – 2001 to be exact - Congress scheduled the repeal of the estate tax provisions for 2010. While the Republican-controlled House of Representatives wanted to completely repeal the estate tax, they unable to do so as a result of the Senate's "Byrd Rule", and, as a result, the repeal "sunsetted" after 2010.[16]

---

[13] The following states impose a separate estate tax (exclusion amount for 2019 stated in parenthesis): Connecticut ($3,600,000 million, increasing to the federal BEA in 2020 (*see* Conn. Gen. Stat. §12-391(g)(5))); District of Columbia ($5,681,760; *see* D.C. CODE § 47-3702); Hawaii ($5,490,000; *see* HAW. REV. STAT. § 236E-6 and Hawaii Dept. of Tax. Ann. 2018-13)); Illinois ($4,000,000; *see* 35 ILL. COMP. STAT. §402/2); Maine ($5,700,000 (exemption is set at $5,600,000 and is adjusted for inflation for decedent's dying after January 1, 2018); *see* ME. REV. STAT. ANN. tit. 36 §§4102 and 4119); Maryland ($5,000,000; *see* MD. CODE ANN., TAX-GEN. §§ 7-305 and 7-309)); Massachusetts ($1,000,000; *see* Mass. Gen. Laws 65C §§ 2A); Minnesota ($3,000,000; increasing to $3,000,000 for 2020 and thereafter; *see* MINN. STAT. ANN. §§ 291.005; 291.03); New York ($5,740,000 (exemption amount is what the federal exemption would be prior to the 2017 Act); *see* N.Y. TAX § 952(c)(2)(B)); Oregon ($1,000,000; *see* OR. REV. STAT. § 118.010); Rhode Island ($1,561,719 (exemption is $1,500,000 adjusted for inflation after 2015); *see* R.I. GEN. LAWS § 44-22-1.1); Vermont ($2,750,000; *see* VT. ST. ANN. tit. 32 § 7442a); and Washington ($2,193,000; Wash. Rev. Code § 83.100.020). Connecticut is the only state to impose a separate gift tax. A few additional states impose a separate inheritance tax, including Iowa, Kentucky, Maryland, Nebraska and Pennsylvania. Maryland is the only state that imposes both an estate tax and an inheritance tax. The inheritance taxes are typically less than the separate estate taxes and/or only apply to the receipt of property by certain groups.

[14] Md. Code Ann., Tax-Gen. § 7-309(b)(3)(6).

[15] Section 2058.

[16] ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT OF 2001 (Pub.L. 107–16, 115 Stat. 38, June 7, 2001) (the "2001 Act").

(b) What is the "Byrd Rule"?

(i) The Byrd Rule was adopted in 1985 and named for then West Virginia Sen. Robert Byrd, and generally applies to certain reconciliation bills that affect the budget. If a reconciliation bill contains an extraneous matter (such as one that would increase the federal deficit), a 3/5 majority (which, in a full Senate, is 60 votes), as opposed to a simple majority vote, is required to pass the bill as drafted; if the vote is at least a majority but less than the required 3/5 votes, the legislation is considered to be passed by the Senate, but must terminate in less than 10 years (i.e., it "sunsets"), upon which the law as it existed before the new legislation's passage would once again be the applicable law.[17]

(ii) As the Republicans were unable to obtain 60 votes for the Senate's passage, the 2001 Act was passed by a majority of the Senate and became law, but the Byrd Rule forced the sunset after 2010.

(c) Fast forward to 2017. With the Republicans holding only 51 Senate seats, and considering the Congressional acrimony surrounding the tax legislation, 60 votes supporting the 2017 Act was impossible; in fact, many were worried that the Republicans would not be able to garner the 50 votes needed for passage.[18]

(d) Thus, although the 2017 Act was passed by the Senate, the Democrats invoked the Byrd Rule because the 2017 Act affected the budget deficit within the certain parameters. As expected, the Republicans were not able to garner the required 60 favorable votes in the Senate, so the doubling of the Exclusions will sunset in 2026.

(4) Total repeal of the estate tax continues to be alluring to some, but it is too ephemeral to warrant serious reliance.

(a) This is based on the history of the modern estate tax, where the tax was repealed for only one year out of the past 102 years, and even then, repeal was short-lived as legislation made the estate tax "optional."[19]

(b) Moreover, the policy of the estate tax has long been to further the social policy of breaking up large concentrations of wealth. By some measures, the United States is the most unequal first world country in terms of wealth and income inequity.[20]

(c) The core point is that it's imprudent to entrust the security of family wealth to Congressional action or inaction on the estate tax.

---

[17] The 2017 Act creates deficits. The only way to pass a bill that is deficit-burdened is for it to be passed as part of the annual budget reconciliation. However, to undo many parts, if not all, of this 2017 Act, it would be much easier for a Democratic Congress and White House, because undoing legislation that creates a surplus simply needs a simple majority in both Houses of Congress, and the legislation could be done through the use of a stand-alone bill (avoiding the budget reconciliation process and the Byrd Rule). Thus, the 2017 Act's undoing could occur much quicker and with much less fanfare by comparison to its passing if there is a shift of power. *See* http://archives-democrats-rules.house.gov/archives/byrd_rule.htm for the House of Representatives' Committee on Rules analysis of the Byrd Rule.

[18] Wait…why isn't this a majority? Under Article I, section 3 of the United States Constitution, the Vice President of the United States shall be the President of the Senate, but shall have no vote, unless they be equally divided. As the tax legislation was a Republican sponsored bill, a tie vote would mean approval as the Vice President is a Republican.

[19] *See* Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub.L. 111–312 (December 17, 2010) at § 301.

[20] This economic disparity is more pronounced in the United States than other first world countries. *See* T. Piketty, *New Thoughts on Capital in the Twenty-First Century*, TED Talks (June 2014).

(5) Use It or Lose It - the Exclusion Increase is Temporary!

(a) The key point is that the "doubling" of the Exclusions is temporary (*i.e.*, they sunset or are sooner reduced).

(i) For those that can afford to do so, using the new Exclusions sooner, rather than later, is advisable.

(ii) For the analysis below, the original or "constant" Exclusion amount, *i.e.*, the first $5.6 million, is referred to as the "Original Exclusion Amount", and the new Exclusion granted under the 2017 Act is referred to as the "New Exclusion Amount".

(b) A concern for practitioners advocating current gifting of the New Exclusion Amount is whether the taxpayer would receive credit for its usage if, and when, the New Exclusion Amount was either repealed or sunsetted.

(i) This concept, colloquially referred to as the "clawback," could have detrimental effects on the taxpayer as, if credit were not afforded for the use of the New Exclusion Amount, the calculation methodology under § 2001 would impose a phantom estate tax upon the individual's death.

(ii) Although it was understood from the passage of the 2017 Act that no clawback would occur,[21] without any official statement from Treasury or the Internal Revenue Service (the "IRS"), the clawback issue was still a possibility.

(iii) Fortunately, Treasury's issued Treas. Reg. §20.2010-1(c), which clarified that the so-called "clawback" is not a concern when the 2017 Act sunsets.[22]

(I) If any portion of the New Exclusion Amount is used through lifetime gifts, the taxpayer will get credit for having utilized the New Exclusion Amount at the time that the gifts were made, even if the New Exclusion Amount is eliminated.[23]

(II) Note, however, that the Regulations also clarify that, in terms of the hierarchy of usage of the AEA, the Original Exclusion Amount is utilized first. This is logical because the Original Exclusion Amount will always be the constant amount, *i.e.*, it was the amount before the 2017 Act and will be again the amount after the 2017 Act sunsets. Under this approach, in order to obtain the credit for any utilized New Exclusion Amount, the full amount of Original Exclusion Amount would have to be completely exhausted.

(c) If the wealth holder survives into 2026 and has not already used the New Exclusion Amount, in terms of determining his or her transfer tax status, it will be as if the Exclusions never doubled. Considering that most Americans cannot afford to give away $11,400,000 during lifetime,

---

[21] *See* § 11061 of the 2017 Act, in which Congress directed Treasury to prescribe such regulations as may be necessary or appropriate to carry out § 2001 with respect to any difference between the BEA applicable at the time of the decedent's death and the BEA applicable with respect to any gifts made by the decedent.

[22] While the Regulation does not contemplate a legislative reduction in the BEA, the popular belief is that the Regulation would nevertheless apply.

[23] Congress intended this result. In the Conference Committee report to the Act, the committee stated that, "As a conforming amendment to section 2010(g) (regarding computation of estate tax), the provision provides that the Secretary shall prescribe regulations as may be necessary or appropriate to carry out the purposes of the section with respect to differences between the basic exclusion amount in effect: (1) at the time of the decedent's death; and (2) at the time of any gifts made by the decedent." JOINT EXPLANATORY STATEMENT OF THE COMMITTEE OF CONFERENCE, CRPT-115 HRPT at p.144. In 2012, when faced with a similar "clawback" issue, Treasury issued regulations in the Portability arena confirming that there would be no clawback if any deceased spousal unused exclusion amount was used. *See* Treas. Reg. § 20.2010-3.

it stands to reason that most individuals will receive no benefit from the New Exclusion Amount before it rolls back and is eliminated.

(d) Therefore, the opportunity exists to reduce transfer taxes for those few wealth holders who could utilize the New Exclusion Amount by making lifetime gifts before any roll back occurs.[24]

(e) Using the New Exclusion Amount as soon as possible will allow greater leverage for transfer tax purposes – *e.g.*, all post-gift appreciation in the assets given avoids being part of the base for taxation in the wealth holder's estate.[25]

(6) More Affluent Spouse Can Fully Utilize His or Her New Exclusion Amount, but Less Affluent Spouse Cannot Fully Utilize His or Her New Exclusion Amount

(a) With the above background, now consider the scenario where a married couple has a drastic disparity in wealth – one spouse holds almost all of the couple's combined wealth and such wealth exceeds the wealth holder's Exclusions.

(i) This situation might arise when neither the More Affluent Spouse nor the Less Affluent Spouse have used their respective Exclusions and now there is a concern about the roll back.

(ii) Alternatively, the situation may be that the More Affluent Spouse has already used his or her Exclusions but the Less Affluent Spouse's Exclusions remain unused.

(iii) Often this occurs when the More Affluent Spouse has remarried and the newer spouse has his or her full allotment of Exemptions because he or she was never in a financial condition to consider utilizing them.

(b) In each of the above scenarios, the More Affluent Spouse realizes that, instead of wasting the Less Affluent Spouse's Exemptions, perhaps they could be put to use by transferring some of the More Affluent Spouse's wealth to his or her descendants.

(c) Very wealthy families that have learned the value of using the Exclusions of all family members, including the Less Affluent Spouses of the second, third and more remote generations.

(i) Frequently, these spouses of the lower generations are from more modest circumstances.

(ii) Many times these spouses are young and the family may desire to use such Exclusions before such lower generation couples have children.

(iii) As explained below, these Exclusions have significant value, even if the in-law cannot easily make use of the Exclusions otherwise. Therefore, the family must approach this effort with caution.

(d) A frequent objective is for the More Affluent Spouse to retain benefits and control over the gifts while still benefiting the succeeding generations.

[24] Of course, another possibility is that Congress extends the current law and no roll back in the gift exclusion levels occurs.

[25] Maximizing the value of the exclusions might involve giving assets subject to valuation discounts and having strong growth potential. Carefully considering the gift structure is important. For example, the gift structure should mitigate the risks of the IRS complaining that the transferred asset's valuation is too low. Additional wealth transfer benefits are available by making the gifts to trusts for which wealth holder must continue to pay the income taxes.

(i) To achieve this result, all roads lead to the More Affluent Spouse creating a trust for this purpose.

(ii) If a trust is to be utilized, ideally, the More Affluent Spouse would further want the trust to be structured so that he or she would pay the trust's income tax, meaning that the trust would be a grantor trust as to the More Affluent Spouse – *i.e.*, all items of income, deduction and credit of the trust is taxed to him or her. Such taxation allows the trust to grow in value free from income taxation which exponentially enhances the power of compounding inside the trust.[26]

(iii) Assuming that these objectives can be met, the More Affluent Spouse would like to go "all in" and have the trust benefit himself or herself and have spendthrift protection so that the trust is not reachable by the More Affluent Spouse's creditors.

(e) The economics of the Less Affluent Spouse consenting to the use of his or her Exclusions should be considered.

(i) In effect, these are valuable tax breaks.

(ii) Note that this outline does not address whether the Less Affluent Spouse should be compensated for allowing the use of his or her Exclusions – each situation would be likely be unique as to whether compensation of some form is warranted and to what degree.

(A) If the planner represents both spouses, consider the impact of Rule 1.7 of the Model Rules of Professional Conduct, addressing conflicts of interest, and whether separate representation is needed.[27]

(B) Suppose that the issue of compensating the Less Affluent Spouse is never discussed and, after the plan is implemented, the couple ends their marriage. When the Less Affluent Spouse realizes that his or her Exclusions have been utilized, he or she may start to feel as if his or her generosity should have been compensated.

(C) The lawyer who represented both spouses may be an easy target for criticism.

C. Ways to Utilize the Exclusions of the Less Affluent Spouse

(1) Fact Pattern Example

(a) The most efficient way to introduce and explain the techniques to utilize the Less Affluent Spouse's Exclusions is to introduce a not-so-uncommon fact pattern. In all scenarios, any gifting or transfers occurs in 2019.

(b) Example –

(i) Henrietta's first husband, Hal, died in 2004.

---

[26] For more detail on grantor trusts, *see* Richard S. Franklin & Lester B. Law, *Extraordinary, Efficient, Elegant, Evolutionary: The Annual Taxable Gifts Approach and Testamentary CLAT Remainder*, 51ST HECKERLING INSTITUTE ON ESTATE PLANNING (January 11, 2017). The economic analysis included in this paper amply demonstrate the extraordinary power of using grantor trusts.

[27] *See* https://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/rule_1_7_conflict_of_interest_current_clients/.

(ii) Henrietta has two children by Hal and no future children are expected. Henrietta married Edward in 2008.

(iii) Edward has no children and $500,000 in assets.

(iv) Henrietta has $50,000,000 in assets and would like to use Edward's Exclusions for the benefit of her children by Hal.

(v) Henrietta understands portability, but she is focused on using Edward's Exclusions while the New Exclusion Amount is available, and to do so by funding lifetime GST trusts for her descendants (the "Descendants GST Trust").

(2) Split-Gifts to Henrietta's Descendants GST Trust – the "Split-Gift" Plan

(a) Introduction

(i) The easiest way to utilize a spouse's Exclusions is to engage in gift-splitting. Under this approach, assuming that Henrietta has not already used her Exclusions, she could create the Descendants GST Trust and transfer $22,800,000 of her assets into it (the "Split-Gift Plan").

(ii) In some situations, the split-gift election may offer a palatable solution, but, as described below, it carries some risks.

(b) Gift, Estate and GST Tax Implications to Edward

(i) Assuming that Edward agrees to make a split-gift election on Henrietta's 2019 Form 709, U.S. Gift (and Generation-Skipping Transfer) Tax Return (the "709"), he will be deemed to be the transferor of one-half of the assets for gift,[28] estate and GST tax purposes.

(ii) The deemed gift will use both of Edward's $11,400,000 AEA and his $11,400,000 GST Exemption.[29]

(c) The Split-Gift Plan is not perfect.

(i) Suppose that the gift occurs on March 1, 2019.

(I) The split-gift election is not made until the 709 is filed for the year of the gift, which, for 2019 gifts, is not required to be filed until April 15, 2020, or October 15, 2020 if the deadline is extended.

(II) Until the 709 has been filed with the Edward consenting to the split-gift election, there is no guarantee that Edward will consent to split the gift.[30]

(III) For the next 13 ½ calendar months (perhaps 19 ½ months if Henrietta elects to file her 2019 709 on extension), Henrietta is exposed to potential to gift tax liability.

(IV) This may be uncomfortable for Henrietta, as much can occur over that time period. For example, what if the marriage begins to sour and Edward files for divorce by

---

[28] Treas. Reg. § 25.2513-1(a).

[29] Be design, short shrift is given in this article to the split-gift election, but note that this election has a lot of nuance – *e.g., see* Murrah, *Gift Splitting for Transfers in Trust (Do You Really Know These Rules?)*, (Memphis, TN, April 2009); Diana S.C. Zeydel, *Gift-Splitting – A Boondoggle or a Bad Idea? A Comprehensive Look at the Rules*, 106 J. TAX'N No. 6, p. 334 (June 2007); Carmen Irizarry-Diaz, *Effective Use of the Election to Split-Gifts*, 26 BLOOMBERG BNA TAX MANAGEMENT ESTATES, GIFTS AND TRUST JOURNAL, No. 6, p. 247 (November/December 2001).

[30] Section 2513(c).

December 2019. Edward is not required to consent to split the gift, so, without the election, Henrietta would owe gift taxes of $4,560,000 (($22,800,000 - $11,400,000 for Henrietta's AEA) x 40%)!

(ii) To protect Henrietta from this concern, she and Edward could enter into a post-nuptial agreement prior to effecting the gifts to the Descendants GST Trust.

(I) In the agreement, Edward could agree to be required to consent to the split-gift election for all of Henrietta's 2019 gifts.

(II) Of course, this raises issue of what consideration Henrietta would have to provide for Edward's agreement.

(III) Moreover, such an agreement would be subject to the typical "best practices" guidelines applicable to nuptial agreements, such as a full and fair disclosure of by each spouse of their respective and joint assets and each spouse obtaining separate and independent legal representation.[31]

(IV) These obstacles and associated costs may make such an agreement impracticable.[32]

(iii) The Split-Gift Plan would also likely be unattractive if Henrietta has already used her Exclusions.

(I) This is because Henrietta would need to make a taxable gift of $22,800,000 for the split-gift election to use Edward's entire Exclusions.

(II) Henrietta, having no AEA available, would have to pay gift taxes at 40% on the one-half of the transfer of which she would be considered to be the transferor (for both gift and GST tax purposes), or $4,560,000 ($11,400,000 x 40%).

(III) Further, one-half of the transfer would not be exempt from the GST tax because Henrietta would not have any remaining GST Exemption to allocate to her portion of the gift.

(IV) Thus, the split-gift election is frequently not scalable without triggering gift tax exposure if the spouses' remaining Exclusions are unequal in amount.

(d) Control

(i) With the Split-Gift Plan, Henrietta is in complete control of the Descendants GST Trust's design. She need not grant Edward any control over the assets or the trust.

(ii) For example, Edward is not required to be a beneficiary of the Descendants GST Trust, or a trustee or investment manager of the trust.

---

[31] Note that the requirements for nuptial agreements vary from state to state, and in most states, separate legal representation is not a requirement for a valid nuptial agreement. However, in order to reduce the likelihood of a challenge to a nuptial agreement, it is customary for each such agreement to require full financial disclosure and separate legal representation.

[32] However, to immediately reject a plan based on entering into a post-nuptial agreement should not be arbitrarily dismissed due to the costs involved. Considering the transfer tax savings generated by the Split-Gift Plan, the cost of a post-nuptial agreement should be relatively *de minimis* by comparison. However, there may be other mitigating factors that could rule out a post-nuptial agreement between the parties, such as that they may already have a prenuptial agreement in place and the discussion of a post-nuptial agreement could lead to a re-opening of negotiations involving the prenuptial agreement, which one party may not see as advantageous to him or her.

(iii) Moreover, it is not necessary for Edward to have any power of appointment or have any other interest or concern with the trust.

(e) Creditors

(i) Assuming that the trust contains a spendthrift clause (or the law of the particular jurisdiction automatically imposes spendthrift protection to third party trusts), the assets transferred to the Descendants GST Trust would never be exposed to Edward's creditors, because the fiction that he is a transferor of property is only for federal transfer tax purposes.

(ii) The assets funding the Descendants GST Trust should also be protected from Henrietta's creditors because she has no beneficial interest in the trust (unless her transfers to the trust are deemed to violate her state's fraudulent or voidable transfer laws, which can be the case if it is determined that she intended to hinder, delay or defraud any of her creditors).[33]

(f) Grantor Trusts as to Henrietta

(i) As an extra bonus to this plan, the Descendants GST Trust is designed as a grantor trust for income tax purposes.

(ii) Because the split-gift election is only a transfer tax fiction created under the Code, it does not apply for income tax purposes.

(iii) As a result, Henrietta is the grantor of the entire trust for income tax purposes.

(iv) This is beneficial because Henrietta has the wealth from which to pay the income taxes.

(g) Step-Transaction Doctrine

(i) A concern in any multi-step planning technique is the threat that the IRS may attempt to undo the transaction by applying the step-transaction doctrine (the "Step-Transaction Doctrine").

(ii) Usually, the Step-Transaction Doctrine is invoked when, for example, a taxpayer intends for a preferential tax result, but cannot achieve the result on his or her own.

(iii) Instead, the taxpayer must undertake several steps to be taken not only by him or her, but by others.

(iv) Case law has created the Step-Transaction Doctrine as a variation on the substance-over-form doctrine, the purpose of which is to ensure that transactions are taxed according

[33] Forty-four of the 51 jurisdictions have adopted either the Uniform Fraudulent Transfer Act (the "UFTA"), as promulgated by the National Conference of Commissioners on Uniform State Law ("NCCUSL") in 1983, or the more recent Uniform Voidable Transactions Act (the "UVTA"), as promulgated by NCCUSL in 2014. Common to both Acts is § 4(a)(1), which provides that a transfer made or obligation incurred by a debtor is fraudulent/voidable (depending on the particular act – the UFTA uses "fraudulent" and the UVTA uses "voidable") as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation with actual intent to hinder, delay, or defraud any creditor of the debtor.

to their substance and not their outward form; accordingly, a court will not apply the Step-Transaction Doctrine if the substance of the transaction does not differ from its form.[34]

(v) The Split-Gift Plan to using Edward's Exclusion does not pose any concern with the Step-Transaction Doctrine because the Step-Transaction Doctrine is not applicable to gift-splitting – the actions by the spouse in electing to split the gift are statutorily granted to the spouse. In other words, the Code specifically authorizes the spouse to split gifts. No additional steps are needed.

(h) Psychological Effect to the More Affluent Spouse of the Permanent Divesture of Assets

(i) Creating a trust to benefit Henrietta's descendants causes the total divestiture of the transferred assets from her, meaning that she forever loses the use and benefit of the $22,800,000.

(ii) For many clients, even if they have sufficient other assets whereby the gifts would not affect the client's standard of living, the thought of forever transferring $22,800,000 is concerning, even if the risk is merely perceivable and not actual.

(3) Marital Gift Followed by Re-Gift to Descendants GST Trust

(a) Introduction

(i) Regardless of whether Henrietta has any portion, or all, of her Exclusions available, another option is for Henrietta to give Edward $11,400,000 of assets and then, at some point in the future, Edward gifts $11,400,000 to the Descendants GST Trust, or creates a new Descendants GST Trust that only benefits Henrietta's descendants (the "Marital Gift/Re-Gift Plan").

---

[34] William W. Chip, *Bloomberg Tax Portfolio 508-2nd: The Economic Substance Doctrine*, Sec. III.D(1), Footnotes 298 and 299, *citing* Commissioner v. Clark, 489 U.S. at 738 ("Under [the step transaction] doctrine, interrelated yet formally distinct steps in an integrated transaction may not be considered independently of the overall transaction."); Brown v. United States, 329 F.3d 664, 671 (9th Cir. 2003) ("The [step transaction] doctrine is part of the broader tax concept that substance should prevail over form.") (*quoting* Associated Wholesale Grocers, Inc. v. United States, 927 F.2d 1517, 1521 (10th Cir. 1991)); Kanawha Gas & Utils. Co. v. Commissioner, 214 F.2d 685, 691 (5th Cir. 1954) ("[substance-over-form] is particularly pertinent to cases involving a series of transactions designed and executed as parts of a unitary plan to achieve an intended result. Such plans will be viewed as a whole regardless of whether the effect of so doing is imposition of or relief from taxation. The series of closely related steps in such a plan are merely the means by which to carry out the plan and will not be separated."); Associated Wholesale Grocers, Inc. v. United States, 927 F.2d 1517, 1521 (10th Cir. 1991) ("The step-transaction doctrine developed as part of the broader tax concept that substance should prevail over form."); True v. United States, 190 F.3d 1165, 1174 (10th Cir. 1999) (the step transaction doctrine is an "incarnation of the basic substance over form principle"); Sec. Indus. Ins. Co. v. United States, 702 F.2d 1234, 1244 (5th Cir. 1983) ("The step transaction doctrine is a corollary of the general tax principle that the incidence of taxation depends upon the substance of a transaction rather than its form."); Greene v. United States, 13 F.3d 577, 583 (2d Cir. 1994) ("By emphasizing substance over form, the step transaction doctrine prevents a taxpayer from escaping taxation. The doctrine treats the 'steps' in a series of formally separate but related transactions involving the transfer of property as a single transaction, if all the steps are substantially linked."); Penrod v. Commissioner, 88 T.C. 1415, 1428-30 ("The step transaction doctrine is in effect another rule of substance over form; it treats a series of formally separate 'steps' as a single transaction if such steps are in substance integrated, interdependent, and focused toward a particular result."); Teong-Chan Gaw v. Commissioner, T.C. Memo 1995-531 at 124 ("The step transaction doctrine developed from the substance over form doctrine.") (*citing* Associated Wholesale Grocers, Inc. v. United States, 927 F.2d at 1521); MAS One LP v. United States, 271 F. Supp.2d 1061 (S.D. Ohio 2003), aff'd, 390 F.3d 427 (6th Cir. 2004) ("The step transaction doctrine is inapplicable in this case because the substance and the form of the transactions in question do not differ in any meaningful way."); Tracinda Corp. v. Commissioner, 111 T.C. 315, 326 (1998) ("in order to apply either the substance-over-form doctrine or the step-transaction doctrine, we must determine that the substance of the transaction differs from its form."). See also FAA 20123401F (where substance of installment sale followed by loan monetizing installment sale notes was determined to be consistent with form, step transaction doctrine was inapplicable).

(ii) For many clients, this seems to be the most logical – and easiest – approach, as it would avoid the delay in confirming the split-gift.

(iii) For the reasons outlined below, however, the Marital Gift/Re-Gift Plan is unlikely to be the best solution.

(b) Estate, Gift and GST Tax Implications to Edward

(i) Following Henrietta's gift to Edward, he becomes the owner of the assets.

(ii) Presumably, this approach envisions that Edward will be vested with full fee ownership. As such, he would become the transferor of the assets for all purposes.

(iii) Upon Edward's subsequent gift to the Descendants GST Trust, Edward will be the transferor of the assets for income, gift, estate and GST tax purposes.

(iv) The subsequent gift will use Edward's $11,400,000 AEA and his $11,400,000 GST Exemption.

(c) Control

(i) With the Marital Gift/Re-Gift Plan, Henrietta can still be in complete control of the design of the Descendants GST Trust.

(ii) Similar to the Split-Gift Plan, she does not need to grant any interest or control to Edward in the trust. However, following Henrietta's gift to Edward, the assets are exposed to Edward's control and he – and he alone - decides whether to give property to the Descendants GST Trust.

(iii) This plan also raises marital law implications - as an inter-spousal gift, it would likely convert the property from Henrietta's separate property to marital property or perhaps to Edward's separate property.[35]

(d) Creditors

(i) The assets transferred to Edward would be exposed to Edward's creditors, which is one of the most significant pitfalls to this approach.

(ii) Consider that the assets transferred by Henrietta to Edward should be protected from Henrietta's creditors unless her transfer is deemed to be a fraudulent/voidable transfer.

(iii) Likewise, Edward's subsequent gift to the Descendants GST Trust should also be protected from his creditors unless his transfer is deemed to be a fraudulent/voidable transfer.

(iv) Note that under this approach, there are <u>two</u> potential fraudulent/voidable transfer inquiries.

---

[35] *For example, see* FLA. STAT. § 61.075(6)(a)1.d. ("Marital assets and liabilities" include … interspousal gifts during the marriage.). Other states may also deem interspousal gifts to be marital property, but do so by negative inference: *see* VA. CODE § 22-107.3.A.1 ("Separate property is … all property acquired during the marriage by gift from a source other than the other party.") and VA. CODE § 22-107.3.A.2. ("Marital property is … all other property acquired by each party during the marriage which is not separate property as defined above."); and N.Y. DOM. REL. LAW §236, Part B.1.d.(1) ("The term separate property shall mean property acquired before marriage or property acquired by bequest, devise, or descent, or gift from a party other than the spouse.").

(e) Grantor Trust Status

(i) Even if the other obstacles could be successfully navigated, this approach makes Edward, and not Henrietta, the grantor for income tax purposes of the portion of the Descendants GST Trust represented by Edward's contribution to the trust or of the separate Descendants GST Trust created by Edward.

(ii) This approach is not ideal because Henrietta has the wealth from which to pay the income taxes. After all, it would be preferable from Henrietta's perspective to have Edward completely removed from the plan once his Exclusions are used.

(iii) Assuming that Henrietta and Edward remain married, this does not pose that much of an inconvenience if they elect "Married Filing Jointly" status for their income tax returns, so long as they are married.

(I) By doing so, Edward's portion of the income is reported on the same income tax return as Henrietta's, so Henrietta can pay the income tax without any adverse consequences.

(II) However, should they divorce, the grantor trust status for Edward becomes more problematic.

(III) Assuming that Edward's contribution was to Henrietta's Descendants GST Trust, Edward is still the grantor of the portion representing his contribution to the trust (presume that Edward's portion represents 50% of the trust), but Edward has no individual funds from which to pay the taxes. Therefore, assuming that the trust contains an "income tax reimbursement clause",[36] either the trustee would have to exercise the authority and pay to Edward the income taxes owed on his share (and thereby reducing the exponential compounding associated with grantor trust status), or Henrietta would have to pay the income taxes by making annual and/or taxable gifts to Edward (which is also the only solution if the trust does not contain an income tax reimbursement clause).

(iv) Even absent a divorce, if the objectives are to utilize Edward's Exclusions and not have him involved in any other aspect of the plan, the second objective would fail because, as a grantor trust, Edward would receive the trust's 1099s reporting the trust's taxable income.

(I) This would serve as an annual reminder of Henrietta's wealth and inheritance plan (and Edward's role in allowing the use of his Exclusions).

(II) Moreover, in a divorce scenario, Edward would still be the grantor of his portion for income tax purposes and would continue to receive information about the trust.

(v) Even without a divorce, the plan is hampered if Edward were to predecease Henrietta.

(I) Edward's death terminates the grantor trust status of Edward's portion of the trust.

[36] Often, a grantor trust will include an "income tax reimbursement" clause, which allows the trustee of the trust to reimburse the grantor for the income taxes owed by the grantor as a result of the grantor trust status of the trust. Note that where the trustee of an irrevocable trust that is a grantor trust reimburses the grantor for the amount of the income tax attributable to the inclusion of the trust's income in the grantor's taxable income, as required or permitted under the trust's governing instrument or applicable state law, the trust beneficiaries are not treated as making a gift of the amount of the income tax to the grantor. *See* Rev. Rul. 2004-64, 2004-27 I.R.B. 7. Further, some states specifically provide that such reimbursement is not an amount that is "distributed to or for the settlor's benefit" and therefore is not attachable by the settlor's creditors. *See* VA. CODE § 64.2-747.A.2.; FLA. STAT. §736.0505(1)(c).

(II) Prior to his death, the trust was bifurcated for federal income tax purposes, and after his death, it remains bifurcated as Edward's portion now becomes a separate taxpayer responsible for the payment of its own income taxes.

(f) Step-Transaction Doctrine

(i) The Marital Gift/Re-Gift Plan is almost a textbook example of the Step-Transaction Doctrine.

(ii) Recall that Henrietta has excess assets and Edward has none. Henrietta gifts Edward funds that "coincidentally" are equal to the amount of Edward's Exclusions, and then, at a later date, Edward either,

(iii) Contributes those same funds to a trust for Henrietta's descendants, or

(iv) He creates a trust for the benefit of Henrietta's descendants and then transfers said funds into said trust.

(v) It would appear as if the IRS would not have much difficulty in applying the Step-Transaction Doctrine to this technique by arguing that the use of Edward's Exclusions is the result of a prearranged plan between Henrietta and Edward and that the gift to Edward is a sham and should be ignored — *i.e.*, that Henrietta, and not Edward, is the real donor of the assets to the trust for Henrietta's descendants.

(vi) Further, in a second marriage situation with a prenuptial agreement, there may be negotiated provisions as to the amount of assets to be transferred by the More Affluent Spouse to the Less Affluent Spouse.

(vii) The gift of the Less Affluent Spouse's Exclusion amount may be more value than the Less Affluent Spouse is entitled to receive under any circumstances by the agreement's terms.

(viii) If so, this could be even more proof to the IRS that the gift to the Less Affluent Spouse is a sham – why would someone receive $11,400,000 and then divest himself of the entire amount if this weren't a prearranged plan to benefit Henrietta.

(g) Discretionary Benefits to More Affluent Spouse

(i) Suppose the parties desire that, should Edward elect to transfer funds to the GST Descendants Trust, then, based on the above grantor trust issues and for easier record keeping, it is better that Edward create a separate GST Descendants Trust.

(ii) In order to distinguish this transfer from the suggestion of a prearranged plan, Edward could make Henrietta a discretionary beneficiary of his Descendants GST Trust (*i.e.*, a so-called "spousal lifetime access trust", or "SLAT").

(iii) Assuming the other concerns can be resolved favorably, this is an advantage of the Marital Gift/Re-Gift Plan over the Split-Gift Plan because, as a beneficiary of the SLAT, Henrietta now has access to the funds.

(iv) Instead of losing full control and access over $22,800,000, she has only lost full control and access of $11,400,000 because she is now a beneficiary of the trust holding the other $11,400,000.

(v) Further, Edward can argue that he is still receiving some benefit from the funds, for if distributions are made to Henrietta, he is an indirect recipient of the distribution as a member of the marital unit.

(4) Lifetime QTIP Trust Plan

(a) Introduction

(i) The third option does not involve outright gifts to the Less Affluent Spouse and nor does it involve much dependency on elections by the Less Affluent Spouse, and yet it accomplishes all of the intended goals of the More Affluent Spouse – this is the "Lifetime QTIP Trust Plan."

(ii) The third option involves a Lifetime QTIP Trust which could be used to establish a controlled plan to use Edward's Exclusions during his lifetime or upon his death while still affording Henrietta the control and access that she desires.

(iii) The Lifetime QTIP Trust also has the advantage of availability regardless of whether Henrietta has any, or all, of her Exclusions available.

(b) The Plan

(i) The Lifetime QTIP Trust Plan begins with Henrietta funding a Lifetime QTIP Trust with $11,400,000 – *i.e.*, the amount equal to Edward's Exclusions. So far, nothing out of the ordinary.

(ii) The next element involves the QTIP election - while the election is made on the timely-filed 709,[37] the key to the election involves the GST tax.

(I) Under the basic GST tax rules, § 2652(a)(1) generally provides that, in the case of property that is subject to the estate tax or the gift tax, the decedent or the donor, as the case may be, is the "transferor" for GST tax purposes, and it is the transferor who determines the GST tax status of a transactions and it is the transferor's GST Exemption that is applied against property that is subject to the GST tax.

(II) With a QTIP election, while the property is subject to the marital deduction for the donor/decedent, upon the death of, or lifetime disposition by, the spouse, § 2044 and § 2519, respectively, subject the property to the estate or gift tax at the time of the death/disposition,[38] and upon such transfer tax imposition, under the definition in § 2652(a)(1), the spouse becomes the transferor for GST tax purposes (and therefore, the spouse's GST Exemption would be applied).

(III) In most instances, when creating a lifetime or testamentary QTIP trust, if the donor has any remaining GST Exemption, the donor (if lifetime) or the donor's executor (if testamentary) would elect under § 2652(a)(3) to treat the donor or the decedent, as the case may be, as the transferor for GST tax purposes (referred to as the "Reverse-QTIP Election").

(IV) As a result of the Reverse-QTIP Election, a fiction is created whereby the donor/decedent remains the transferor for GST tax purposes even though the property will eventually be subject to transfer tax upon the death of, or disposition by, the spouse.

(V) However, with the Lifetime QTIP Trust Plan, regardless of whether she has any remaining GST Exemption, Henrietta *would not make the Reverse QTIP Election*. This way,

---

[37] A great deal of caution is warranted in ensuring that a gift tax return is timely filed and the QTIP election is made because the IRS believes that it does not have discretion to grant a request for an extension of time to make the gift QTIP election. *See* UBIQUITOUS *supra* note 5 at ¶ 1600.2.A.

[38] For a more detailed analysis of the working of §2519 with respect to lifetime dispositions of QTIP property, *see* Richard S. Franklin and George D. Karibjanian, *Portability and Second Marriages – Worth a Second Look*, 39 BLOOMBERG BNA TAX MANAGEMENT ESTATES, GIFTS AND TRUSTS JOURNAL, No. 5, p. 179 (September/October 2014) ("SECOND LOOK").

under the general GST tax rules, Edward would become the transferor of the trust for GST purposes when he either dies or releases his interest in the trust.[39]

(iii) A benefit of this approach is that it scalable to either of the Exclusions or both.

(I) Suppose that Henrietta inadvertently transfers property to the Lifetime QTIP Trust in excess of Edward's available GST Exemption (which could easily have occurred if it is later determined that Edward had previously used a portion of his GST Exemption), such that Henrietta transfers $11,400,000 into the Lifetime QTIP Trust on the premise that Edward has his full $11,400,000 GST Exemption available; however, it is later determined that, in his prior marriage, Edward consented to a gift with his former spouse and had utilized $1,000,000 of his GST Exemption.

(II) When making the QTIP election, if she still has GST Exemption available, Henrietta can make the Reverse QTIP Election but do so by a formula, so that the Reverse QTIP Election only applies to the fractional amount transferred into the Lifetime QTIP Trust equal to the excess of the amount transferred over Edward's available GST Exemption.[40]

(c) Gift, Estate and GST Tax Implications to Edward

(i) As a QTIP trust, upon Edward's death, the value of the trust would be included in his Gross Estate under § 2044, and, as described above, he would become the transferor of the trust's assets for GST tax purposes (this is the effect of Henrietta's not having made the Reverse-QTIP Election). As such, Edward's Exclusions would be used upon his death.

(ii) Alternatively, at some point after the Lifetime QTIP Trust is funded, Edward could *release* his interests.

(I) For example, if Edward became concerned that his New Exclusion Amount should be used in the near future rather than risk it being eliminated by a roll back in the Exclusion amounts, one possibility is that he could release his interests in Lifetime QTIP Trust.

(II) No agreement or obligation to do so should be imposed on Edward at the time the Lifetime QTIP Trust is established.

(III) If Edward entirely releases his interests in the Lifetime QTIP Trust,[41] he would be treated as having made a gift of 100% of the QTIP property[42] because the release would trigger a gift of his income interest under § 2511 and the entire value of the remainder interest under § 2519.

(IV) The gifts triggered by the release would consume Edward's AEA and permit his GST Exemption to be allocated to the Lifetime QTIP Trust.

---

[39] Because the Lifetime QTIP Trust Plan contemplates the full use of Henrietta's GST Exemption, it is unlikely that she would be able to make the Reverse QTIP Trust election; it is nevertheless important in understanding each element of the Lifetime QTIP Trust Plan to emphasize why the election, even if available to Henrietta, would not be made.

[40] If Henrietta does not have any GST Exemption available, the trustee of the Lifetime QTIP Trust would likely undertake sever the trust upon funding, or, if at a later date, undertake a qualified severance under § 2642(a)(3) in order to create two trusts, one of which has a GST tax inclusion ratio of 1 and the other of which has a GST tax inclusion ratio of 0.

[41] Care must be exercised to ensure that Edward may release his interests. A typical spendthrift clause may prohibit a release. To avoid this concern, specifically allow a release by the donee spouse as distinct from an assignment. *See* UBIQUITOUS *supra* note 5 at ¶ 1602.4.

[42] Section 2519. *See* UBIQUITOUS *supra* note 5 at ¶ 1600.2.B.

(V) The Lifetime QTIP Trust would then become the Descendants GST Trust for Henrietta's descendants.

(iii) The result almost seems too foolproof to succeed, so the question that must be asked is whether Edward can subsequently disrupt the plan.

(I) The key to this analysis is that the Lifetime QTIP Trust eventually uses Edward's GST Exemption; "eventually" because his GST Exemption will not be allocated until he either dies or releases his interest.

(II) Attention must be given to § 2632 regarding the special rules for allocation of GST Exemption.

(III) After the GST tax had been introduced in 1986, certain events created a GST tax scenario that was not originally contemplated under Chapter 14 of the Code.

(IV) For example, suppose that an individual created an irrevocable life insurance trust, providing that, upon his or her death, the trust would be distributed outright to his or her three children, per stirpes. The trust then purchased a term life insurance policy on the settlor's life.

(V) Based on a pure life expectancy analysis, the settlor should predecease the children, who would receive the proceeds outright. Further, the fact that the term policy could be terminated without detrimental tax costs to anyone meant that it was not viewed as a viable asset to pass down to subsequent generations.

(VI) As a result, the "best practices" at the time was to not allocate GST Exemption to transfers to the trust, so that such exemption could be better used against other assets that pass to successive generations.

(VII) What happened, however, if a child predeceased the settlor and left surviving descendants? Upon the settlor's death, the deceased child's share would pass directly to the grandchildren, which is the appearance of a direct skip under § 2612(c). Further, this was not a situation where the "predeceased parent" rule of § 2651(e)(1) would apply because the "predeceased parent" rule only applies at the time that the estate or gift tax is imposed, and with the irrevocable trust, the gift tax would have been imposed when the contributions were made to the trust and not upon the settlor's death.

(VIII) Therefore, if the trust were to be protected from the GST tax, a "late allocation" would occur at the settlor's death, and if no GST Exemption was otherwise available, this would result in the imposition of a GST tax.[43]

(IX) To correct this, Congress expanded the "automatic allocation" rules in § 2632.

(X) After enactment, certain transfers that involved direct skips or involved certain trusts would have the transferor's GST Exemption "automatically allocated" to such transfers, thereby protecting them from an inadvertent GST tax.

(XI) What if taxpayers did not want such automatic allocation? Congress addressed this by enacting § 2632(b)(3) and § 2632(c)(5) which allows taxpayers to "opt out" of automatic allocation for such direct skips and transfers to trusts, respectively.

(XII) Since the Lifetime QTIP Trust Plan does not involve direct skips, the focus will be on the certain transfers in trust. If a transferor were to elect to "opt out" of the automatic

[43] *See* Treas. Reg. § 26.2632-1(d)(1).

allocation rules for such trusts, § 2632(c)(5)(B) requires that such "opt out" be elected on a timely filed 709.

(XIII) With this background, suppose that Edward wanted to disrupt the plan, and he determines that the best way to do this is by not allocating his GST Exemption. Can he do this?

(XIV) The first scenario is that Edward dies without having released his life interest in the Lifetime QTIP Trust.

(A) Based on the literal provisions of § 2632(c)(5), even if his personal representatives/executors wanted to "opt out", they would be prohibited from doing so because, as stated above, § 2632(c)(5)(B) provides that any election to "opt out" must be contained in a 709. Edward has died and the transfer is reported on his 706 and not a 709, so the "opt out" is not possible.

(B) What if no allocation is made on Edward's 706 or if no 706 is filed on Edward's behalf (which could occur if the value of the Lifetime QTIP Trust is less than Edward's available AEA)? Unless Edward has subsequently obtained significant other assets and has left them to skip persons, the result is the same because Edward's GST Exemption is automatically allocated to the Lifetime QTIP Trust pursuant to § 2632(e).

(XV) The second scenario is that Edward releases his life estate, thereby causing gift tax recognition under § 2519.

(A) This could present a problem, as § 2519 transfers are reported on a 709.

(B) When the release occurs, Edward would become the transferor, and, as it is his GST Exemption in play, the provisions of § 2632 are applicable to him.

(C) Thus, it is possible that he could "opt out" of automatic allocation in this instance.

(D) To prevent this result, a nuptial agreement may be required to bind Edward to not "opt out" if he were to release his interest; but, as stated previously, to proceed in this manner may cause other issues, such negotiating a cost with the Less Affluent Spouse for the ability to bind him or her to the GST Exemption allocation.

(d) Control

(i) The Lifetime QTIP Trust Plan allows Henrietta's design of the Lifetime QTIP Trust to control the management and disposition of the assets at all times.

(ii) It is not necessary for Henrietta to grant Edward any control over the trust. Moreover, Edward is not required to be a trustee or investment manager, or be granted any power of appointment.

(iii) Other than his income interest, Edward has only one other influence over the trust, which is to decide whether to release his interests in the trust during his lifetime thereby triggering the transfer tax.

(iv) Of course, this control means that Edward could keep the lifetime QTIP interest, which by design must be structured to continue for his lifetime even in the event of their divorce.

(v) Nevertheless, on Edward's death or release of his trust interest, the principal passes to the Descendants GST Trust, so Henrietta will have succeeded in transferring the wealth downward for the benefit of her descendants.

(e) Creditor Protection

(i) The assets transferred to the Lifetime QTIP Trust can be protected from Edward's creditors by structuring the trust as a spendthrift trust.

(ii) The assets funding the Lifetime QTIP Trust should also be protected from Henrietta's creditors if the transfer to the trust is not a fraudulent/voidable transfer because she has no interest in the trust.

(f) Continuing Grantor Trusts as to Henrietta

(i) Another significant advantage of this approach is that, after Edward's death or lifetime release of his income interest, the remaining trust assets can continue in trust for the benefit of Henrietta's descendants.

(ii) While Henrietta is living, such trusts will be grantor trusts as to Henrietta because the trust income is paid to Edward, who, at the time of the creation of the Lifetime QTIP Trust, is married to Henrietta, the trust is a grantor trust as to Henrietta under § 677(a)(1).[44]

(iii) However, reliance should not be solely placed on this provision of the law, as upon Edward's death, grantor trust status would terminate. Therefore, the trust instrument should also contain other grantor trust triggers, such as the power of any person (including the grantor) to reacquire trust assets by substituting other property of equal value (§ 675(4)(c)) or the ability in the grantor to borrow from the trust without adequate interest or security (except where the trustee has a general lending power to make loans to any person without regard to interest or security) (§ 675(2)).

(iv) Assuming that Henrietta is living when Edward dies or releases his interest in the trust, this would allow the continuing trusts for Henrietta's descendants to also be grantor trusts as to Henrietta.

(v) Enabling the assets to be retained in grantor trusts as to Henrietta is a significant income tax advantage over Henrietta simply giving funds to Edward to make gifts in the future to trusts for Henrietta's descendants.

(vi) The income tax treatment as to Henrietta is completely independent of the transfer tax treatment; Henrietta remains the grantor of any continuing trust for her children's benefit under the grantor trust rules, even though Edward's release of his interests in the Lifetime QTIP Trust makes him the transferor for gift and GST tax purposes.

(vii) This result is reliant upon the language of Treas. Reg. § 1.671-2(e)(5), which provides:

> *If a trust makes a gratuitous transfer of property to another trust, the grantor of the transferor trust generally will be treated as the grantor of the*

---

[44] Under § 677(a)(1), the grantor is treated as the owner of any portion of a trust whose income, without the approval or consent of any adverse party, is, or, in the discretion of the grantor or a nonadverse party, or both, may be distributed to the grantor or the grantor's spouse. However, in designing the Lifetime QTIP Trust it is necessary to consider the post-divorce income tax implication of the trust, as § 672(e)(1)(A) defines a "spouse" as any individual who was the spouse of the grantor at the time of the creation of such power or interest. Therefore, even if a divorce occurs, the former spouse is still the "spouse" of the grantor spouse for purposes of the grantor trust rules. *See* UBIQUITOUS *supra* note 1 at ¶ 1600.5.B; Barry A. Nelson & Richard S. Franklin, *Inter Vivos QTIP Trusts Could Have Unanticipated Income Tax Results to Donor Post-Divorce*, LISI ESTATE PLANNING NEWSLETTER #2244 (Sept. 15, 2014). New concerns have arisen as a result of the 2017 Act, which repeals § 682 for divorces occurring after December 31, 2018. *See* George D. Karibjanian, Richard S. Franklin & Lester B. Law, *Alimony, Prenuptial Agreements, and Trusts under the 2017 Act*, 43 BLOOMBERG BNA TAX MANAGEMENT ESTATES, GIFTS AND TRUSTS JOURNAL, No. 3, p. 155 (May/June 2018).

transferee trust. However, if a person <u>with a general power of appointment over the transferor trust</u> exercises that power in favor of another trust, then such person will be treated as the grantor of the transferee trust, even if the grantor of the transferor trust is treated as the owner of the transferor trust under subpart E of the Internal Revenue Code. (emphasis added.)

(viii) Pursuant to this Regulation, a change in grantor for income tax purposes occurs only if someone possesses a general power of appointment over the transferor trust and actually exercises it in favor of another trust. In the example above, Edward would not hold a general power of appointment over the Lifetime QTIP Trust and therefore Henrietta will remain the grantor of the trust for income tax purposes after Edward's release of his interests in the trust.[45]

(g) Step-Transaction Doctrine

(i) A caveat to this plan is to consider any possible application of the Step-Transaction Doctrine.

(ii) If Henrietta creates the Lifetime QTIP Trust and Edward immediately releases his interest in the trust, the IRS might argue that this was part of a pre-conceived plan whereby Henrietta actually was making a gift to her descendants, which would mean that:

(I) Edward's AEA cannot be used to shelter the Lifetime QTIP Trust from transfer taxation, and

(II) Henrietta, rather than Edward, is the transferor for GST tax purposes.

(iii) The good news is that, in Section 2523(f)(1)(B), the Code provides a defense in connection with a Lifetime QTIP Trust.

(I) Section 2523(f)(1)(B) provides that, "for purposes of subsection (b)(1), no part of such property shall be considered as retained in the donor or transferred to any person other than the donee spouse."

(II) Thus, the Code states that, with respect to a transfer to a Lifetime QTIP Trust, the donor spouse, *i.e.*, Henrietta, has not retained an interest in the trust.

(III) Therefore, it would seem implausible for the Step-Transaction Doctrine to be applied to argue that the Henrietta retained an interest in the trust when the "black letter of the law", *i.e.*, the Code, clearly states otherwise.[46]

(IV) Moreover, under the Step-Transaction Doctrine, the donor spouse would have necessarily transferred something to someone other than the donee spouse, which § 2523(f)(1)(B) provides that such a result shall not be considered to have happened.

(iv) These statutory and regulatory deeming rules provide a basis for argument not present in the typical Step-Transaction Doctrine case.

---

[45] *See* Deathbed Lifetime QTIP.

[46] Section 2523(f)(1)(B) has meaning outside just "subsection (b)(1)." This is illustrated in Examples 10 and 11 of Treas. Reg. § 25.2523(f)-(1)(f) with respect to retained interests in resulting trusts from an inter-vivos QTIP trust and the conformation that such interests are not subject to gross estate inclusion under either §§ 2036 and 2038.

(I) For example, in *Linton v. United States,*[47] the controversy concerned whether LLC membership interests were given or whether the gift was of the LLC's underlying assets.

(II) The 9th Circuit Court of Appeals held that the Step-Transaction Doctrine applied if all of the elements of at least one of three tests are satisfied: (i) the "end result test" (*i.e.*, a series of steps taken to reach a particular result), (ii) the "interdependence test" (*i.e.*, questions whether each step useful in its own right or just as part of the series of steps, and is each step commercially reasonable), or (iii) the "binding commitment test" (*i.e.*, applies to transactions over several years where there was a binding commitment to complete the later steps at the time of the earlier steps).

(III) The *Linton* court found none of the tests applicable.

(v) While giving due regard to the technical argument noted above, it is still "best practices" to not "hard wire" the future release (*i.e.*, plan to fail the "end result test"). Instead, a reasonable amount of time should pass between the funding of the Lifetime QTIP Trust and the Less Affluent Spouse's release to demonstrate that the release is truly the free act of the Less Affluent Spouse (*i.e.*, plan to fail the "binding commitment test").

(I) A few years would be best; if possible, perhaps the Less Affluent Spouse should wait for the applicable statute of limitations to run on the 709 on which the QTIP election is made.

(II) Of course, a possible roll back in the Exclusions in the event of a change in the government may influence the Less Affluent Spouse to release earlier in time, but a release based on the roll back of the Exclusions provides more support for an independent decision to release and not a pre-conceived plan.

(III) Note that the gift tax QTIP election, once made on the 709, is irrevocable.[48] Therefore, this provides further support for the proposition for waiting the release until after the QTIP election becomes irrevocable.

(vi) The possible release should be one of several options available to the donee spouse (*i.e.*, plan to fail the "interdependence test").

(I) Consider that, if there were a pre-conceived plan, this could be considered to be a restriction on the income interest, and any limitations on the donee spouse's income interest for life would likely jeopardize the marital deduction.

(II) Therefore, the More Affluent Spouse enters this arrangement with the knowledge that the Less Affluent Spouse may continue the Lifetime QTIP Trust arrangement for life and may never release his or her interests during lifetime to trigger the gift.

(III) This risk is mitigated by the fact that the Lifetime QTIP Trust will eventually use the Less Affluent Spouse's Exclusions upon his or her death (which cannot definitely be stated with respect to a release), and that the only mandatory distributions (i.e., required by the QTIP rules) would be of trust income to the Less Affluent Spouse.

(vii) One suggestion to mitigate the possibility of a successful application of the Step-Transaction Doctrine is to make the split-gift election for the calendar year in which the QTIP election is made.

---

[47] *See, e.g.*, *Linton v. United States*, 630 F.3d 1211, 1224 (9th Cir. 2011).

[48] Section 2523(f)(4)(B).

(I) Pursuant to § 2513(a)(1) and Treas. Reg. § 25.2513-1(b)(4), a gift made by a spouse is eligible for split-gift treatment except for a gift made to the other spouse.

(II) Earlier in this outline, it is stated that, pursuant to § 2523(f)(1)(B), no part of QTIP property can be considered as retained in the donor or transferred to any person "other than the donee spouse."

(III) So, if QTIP property is considered to be retained by the donor and is not a transfer to any person other than the donor's spouse, QTIP property is necessarily deemed to be a gift made to the spouse.

(IV) Therefore, the split-gift election is not available for transfers to QTIP trusts.

(V) On the other hand, despite § 2523(f)(1)(B), if the IRS is successful in arguing the Lifetime QTIP Trust is a sham under the Step-Transaction Doctrine and that all transferred property passed to beneficiaries other than the donee spouse, the split-gift election ought to then be available.

(VI) Once the split-gift election is made it applies to all property transferred during that particular year (*i.e.*, all property other than what is given to the spouse).[49]

(VII) In effect, a best-case scenario is the split-gift election is disregarded; in a worse-case scenario, the split-gift election limits the taxable gift by the More Affluent Spouse to one-half of the transfer.

(VIII) This means that even in this fail-safe situation, the More Affluent Spouse will be in approximately the position that would have been available with the scenario outlined above for the Split-Gift Plan.

(h) Enhanced Benefits to More Affluent Spouse

(i) Introduction

(I) It was previously stated that the More Affluent Spouse would not have a beneficial interest in the Descendants GST Trust.

(II) This may not always be the case, as depending on the jurisdiction of the More Affluent Spouse, the Lifetime QTIP Trust can provide a particular extra benefit in terms of creditor protection in the form of a resulting trust for the benefit of the More Affluent Spouse.

(ii) Overview of DAPTs

(I) To truly understand the benefit of this approach, some background must be provided on the "domestic asset protection trust" (also known as a "self-settled spendthrift trust"), or "DAPT" ("DAPT").

(II) A DAPT is, simply put, a self-settled irrevocable trust wherein income and/or principal may be distributed, as the trustee's discretion, to the settlor. Under the more modern "self-settled spendthrift trust" doctrine, regardless of whether a trust contains a spendthrift clause,

[49] Treas. Reg. § 25.2513-1(b).

the settlor's creditors can reach the maximum amount from the trust that can be distributed to or for the settlor's benefit.[50]

(III) Prior to 1997, in order to achieve creditor protection within a self-settled irrevocable trust, individuals would often create an "asset protection trust" in certain off-shore jurisdictions such as Bermuda or the Cayman Islands.

(IV) In 1997, however, Alaska became the first state to enact legislation authorizing a "domestic" asset protection trusts. As of the date of this outline, DAPT legislation has been enacted in 19 jurisdictions.[51]

(iii) In certain jurisdictions, it may be possible to obtain the benefits from a DAPT even if the jurisdiction has not adopted DAPT legislation.

(I) As cited in Footnote 46, Treas. Reg. § 25.2523(f)-(1)(f), Examples 10 and 11, provide that, if the donee spouse of an Lifetime QTIP Trust predeceases the donor spouse, and the Lifetime QTIP Trust provides that a trust is to then be created to benefit the donor spouse (the "Resulting Trust"), the Resulting Trust will not be included in the donor spouse's Gross Estate upon the donor spouse's death under either §§ 2036 or 2038.

(II) However, what the Regulation does not consider is the effect of creditors on the Resulting Trust. Since, (A) pursuant to the self-settled spendthrift trust doctrine cited above, a settlor's creditors can reach any amounts in a trust created by the settlor that could be distributed for the settlor's benefit, and (B) the Resulting Trust is created in a trust that was created by the settlor, it would appear that the settlor's creditors can reach the assets held in the Resulting Trust, and, if so, this could cause Gross Estate inclusion under § 2041.

(III) To prevent this unintended result, 11 non-DAPT states have enacted legislation (referred to herein as "Quasi-DAPT Legislation") preventing this result by stating that,

---

[50] The "self-settled spendthrift trust" doctrine has been codified by NCCUSL as § 505(a)(2) of the Uniform Trust Code, as last revised in 2010.

[51] The DAPT states are: ALASKA STAT. § 34.40.110; CONN. PUBLIC ACT 19-137, §§99-108; 12 DEL. C. §§ 3536(c)(1), 3570-3576; HAW. REV. STAT. §§ 554G-1-554G-12; IND. CODE §§30-4-8; MICH. COMP. LAWS §§700.1041 - 1050; MISS. CODE §§91-9-701 *et seq.*; R.S. MO. § 456.5-505(3); NEV. REV. STAT. §§ 166.010-166.180; N.H. REV. STAT. ANN. §§ 564-B:5-505(c), 564-D:1-564-D:18; OHIO REV. CODE ANN. §§ 5816.01-5816.14; OKLA. STAT. tit. 31, §§ 10-18; R.I. GEN. LAWS §§ 18-9.2-1-18-9.2-7; S.D. CODIFIED LAWS §§ 55-1-36, 55-16-1-55-16-17, 55-3-39, 55-3-41, 55-3-47; TENN. CODE ANN. §§ 35-16-101-35-16-112; UTAH CODE ANN. § 25-6-502; VA. CODE ANN. §§ 64.2-745.1, 64.2-745.2, 64.2-747(A)(2); W.VA. CODE §44D-5-503a and b.; WYO. STAT. ANN. §§ 4-10-103, 4-10-506(b), 4-10-510-4-10-523.

in the Resulting Trust scenario described above, solely for creditor purposes, the settlor of the Resulting Trust is deemed to be the settlor's spouse and not the settlor.[52]

(IV) The requirement of these statutes is that the Resulting Trust must have been created under a trust that qualified for the gift tax marital deduction under § 2523(f).

(V) Of additional interest, in 9 of the Quasi-DAPT states, the protection is only afforded to a Resulting Trust created upon the death of the settlor's spouse. In Maryland and Michigan, however, the death of the settlor's spouse is not a requirement; in those two states, the same result can be achieved with a lifetime release by the settlor's spouse of his or her interest.

(iv) If Henrietta lives in either a DAPT or Quasi-DAPT jurisdiction, the Resulting Trust following Edward's death could include Henrietta as a discretionary beneficiary.

(I) It is important to recognize that these special statutes allow an exception to the rule against self-settled spendthrift trusts, but without the trust rising to the level of being considered DAPTs in the common understanding.

(II) These statutes, along with the QTIP regulations, prevent the retained interest rules of §§ 2036, 2038 and 2041 from being applicable at Henrietta's death.[53]

II. An Oxymoron? The Deathbed Lifetime QTIP for Basis Adjustment and Asset Protection[54]

A. Introduction

---

[52] This article uses the term "Quasi-DAPT Jurisdiction" which is a derived from the term "Inter-Vivos QTIP Trust Jurisdiction" as coined by Barry Nelson of North Miami Beach, Florida. The 10 Quasi-DAPTJurisdictions that do not authorize DAPTs are: Arizona - ARIZ. REV. STAT. §14-10505 (E); Arkansas – Ark. Rev. Stat. §28-73-505(c); Florida - FLA. STAT. §736.0505(3); Kentucky - KY. REV. STAT. ANN. §386B.5-020(8)(a); Maryland - MD. CODE, EST. & TRUSTS §14.5-1003; Michigan - MICH. COMP. LAWS §700.7506(4); North Carolina - N.C. GEN. STAT. §36C-5-505(c); Oregon - OR. REV STAT. §130.315(4); South Carolina - S.C. CODE ANN. §62-7-505(b)(2); and Texas - TEX. PROP. CODE §112.035(g). The 5 SST States that have enacted Quasi-SST Statutes are: Delaware - DEL. CODE ANN. Tit. 12, § 3536(c); New Hampshire - N.H. REV. STAT. ANN. § 564-B:5-505; Tennessee - TENN. CODE ANN. § 35-15-505(d); Virginia - VA. CODE ANN. § 64.2-747.B.3.); and Wyoming - WYO. STAT. ANN. § 4-10-506(f). Within a SST State that also has enacted a Quasi-SST Statute, a lifetime QTIP could be created to qualify under one statutory scheme or the other or perhaps both. Typically, the requirements to establish a SST Trust are more involved than to qualify a lifetime QTIP under a Quasi-SST Statute.

Most of the Quasi-SST Statutes provide that after the donee spouse's death, if the donor spouse has an interest in the Resulting Trust, the donor spouse is not deemed to be the settlor of the trust that created the Resulting Trust, i.e., the Lifetime QTIP Trust. Tennessee's statute, however, takes a slightly different approach. Rather than deeming the donor spouse to not be the settlor, Tennessee's statute deems the settlor's interest in the Resulting Trust to not be property that may be distributed to the donor spouse..

[53] *Id*. at ¶ 1602.1. If Henrietta does not live in a DAPT or Quasi-DAPT jurisdiction, the issue may become more problematic, especially if Henrietta's domiciliary state has enacted the UVTA without excepting out certain comments. *See* George D. Karibjanian, Richard W. Nenno and Daniel S. Rubin, *The Uniform Voidable Transactions Act: Why Transfers to Self-Settled Spendthrift Trusts by Settlors in Non-APT States Are Not Voidable Transfers Per Se*, 42 BLOOMBERG BNA TAX MANAGEMENT ESTATES, GIFTS AND TRUSTS JOURNAL, No. 4, p. 173 (July/August 2017); George D. Karibjanian, Gerard "J.J." Wehle and Robert L. Lancaster, *A Memo to the States - The UVTA Is Flawed... So Fix It!!!*, LISI ESTATE PLANNING NEWSLETTER #367 (May 1, 2018).

[54] This outline is based on Richard S. Franklin and George D. Karibjanian, *An Oxymoron? The Deathbed Lifetime QTIP for Basis Adjustment and Asset Protection*, BBNA Tax Management Estates, Gifts, and Trusts Journal, Vol. , No. 6 (November 10, 2016) at p.219.

(1) "Deathbed" estate planning is one concept that has always piqued the interest of estate planners. For the most part, death is one of the few great unknowns of the human existence – no one truly knows when one will die.

(2) When the probability of death is heightened, estate planners have long sought to utilize this insight to maximize the wealth transfer potential for the soon-to-be-deceased client and the client's family.

(3) Based on the premise that a client's death is imminent, this outline will combine two distinct concepts - deathbed transfers and self-settled spendthrift trusts - to present a technique that, while only applicable under limited circumstances, could reap big rewards.

B. Introduction to Income Taxation of Deathbed Transfers

(1) Pre-1982 Deathbed Transfer Tax Advantages

(a) Prior to 1982, deathbed planning had significant income tax advantages.

(b) Pursuant to the general rule under §1014,[55] the cost basis of the appreciated asset upon the decedent's death was automatically adjusted to the asset's then fair market value (referred to as the "General Basis Adjustment Rule") regardless of,

(i) the decedent's cost basis in a particular appreciated asset that he or she may own, and

(ii) the timing of the decedent's acquisition of such asset in proximity to his/her death,

(c) Because there were no timing restrictions on the General Basis Adjustment Rule, it was possible to transfer low basis assets to a dying person, have such assets become subject to the General Basis Adjustment Rule upon the decedent's death, and have the dying person bequeath those assets immediately back to the donor.

(d) As a result of acquiring the assets from a decedent, the donor's basis was increased to the assets' fair market value as of the decedent's date of death.

(2) 1982 and the adoption of §1014(e)

(a) This loophole, however, was closed in 1982 with the enactment of §1014(e), which imposes a one year "re-transfer threshold" in order to qualify for the General Basis Adjustment Rule.

(b) Under §1014(e), assets that are gratuitously transferred to a donee and then, within one year thereafter, retransferred back to the donor as a result of the donee's death, no longer qualify for the General Basis Adjustment Rule (referred to as the "One Year Rule").[56]

(c) Beyond this simplistic example, however, the language of §1014(e) is somewhat nebulous and, since its enactment, the Internal Revenue Service (the "Service") has provided little detailed information the application of the One Year Rule.[57]

---

[55] *See generally* §1014(a)(1).
[56] *See* ECONOMIC RECOVERY TAX ACT OF 1981, PL 97-34, 8/13/81, RIA COMREP ¶ 20,561.06 (Unlimited Marital Deduction).
[57] Jeff Scroggin, *Understanding Section 1014(e) & Tax Basis Planning*, LISI ESTATE PLANNING NEWSLETTER #2192 (February 6, 2014) at http://www.leimbergservices.com (referred to in this article as the "Scroggin Article").

C. Deathbed Lifetime QTIP Trust Strategy – An Overview

(1) Example #1

(a) Facts

(i) As of August 1, 2021, W and H, Florida residents, are in their first marriage and are ages 75 and 80, respectively.

(ii) They each have a revocable trust funded (for over 1 year) with $15 million of assets all having a zero basis for income tax purposes in which no portion of the potential gain is income in respect of a decedent.

(iii) Each revocable trust provides that, upon the settlor's death, two trusts are to be created –

(I) first, a pre-residuary pecuniary QTIP trust, to be funded with the minimum amount to reduce federal estate taxes to the lowest possible amount, and

(II) second, a residuary bypass trust to be funded with the balance of the assets.

(iv) The formula adjusts for assets passing outside of the revocable trust that do not qualify for the marital deduction.

(v) Upon the surviving spouse's death, all remaining assets pass to long-term generation-skipping transfer ("GST") tax-exempt and non-exempt trusts for couple's descendants.

(vi) H becomes ill and, with his health in rapid decline, enters hospice care and is expected to die within a few days.

(vii) W and H have made no prior taxable gifts.

(b) W is aware that upon H's death, the entire $15 million of assets in H's revocable trust will be subject to the General Basis Adjustment Rule and that testamentary trusts will be created for her that will provide creditor protection features with a standard spendthrift clause.

(2) Application of the Deathbed Strategy

(a) One way to enhance the facts in Example #1 is to implement a strategy to provide for greater tax and creditor protection benefits.

(b) Introduction to the Deathbed Strategy as to Example #1

(i) Upon the diagnosis of H's terminal condition, W quickly establishes a Lifetime QTIP Trust for H's benefit and funds it with $11.70 million of assets from her revocable trust (all of which, as stated above, have a zero cost basis).

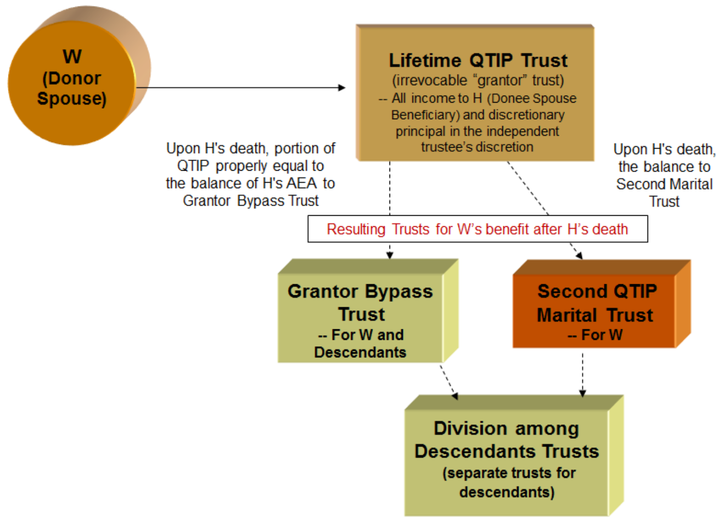
(ii) W timely files a Form 709, U.S. Gift (and Generation-Skipping Transfer) Tax Return (a "709") and elects, pursuant to §2523(f), to qualify the entire Lifetime QTIP Trust for the federal gift tax marital deduction.

(iii) W names a non-trust beneficiary to be the trustee of the Lifetime QTIP Trust (W, however, can be an administrative trustee).

(iv) The Lifetime QTIP Trust provides that, upon H's death, the balance of the trust assets is to be held in a discretionary Resulting Trust for W and W's descendants.

(v) With H's available applicable exclusion amount under §2010 ("AEA") having been allocated against the Resulting Trust, the formula provision in H's revocable trust passes the balance of H's assets to a standard testamentary QTIP trust for W's benefit.

(vi) Alternatively, W could fund the Lifetime QTIP Trust with her entire $15 million of zero basis assets so that the Resulting Trust to be funded upon H's death for W's benefit could be split between a bypass trust and a secondary QTIP trust, illustrated as follows:



(c) General Effect of the Strategy

(i) W's transfer of a minimum of $11.70 million into a Lifetime QTIP Trust is intended to be taxed in H's gross estate[58] in order to create a Resulting Trust utilizing both of H's AEA and his available GST tax exemption under §2631.

(ii) Assuming that W only transferred the $11.70 million into the Lifetime QTIP Trust, the Resulting Trust becomes a "bypass trust" that can provide for discretionary payments of income and principal to any one or more of W and any of W and H's descendants (i.e., similar to a traditional testamentary bypass trust).

(iii) In addition, as described below, the bypass trust is also a "grantor trust" for federal income tax purposes.

(iv) Because the Lifetime QTIP Trust was included in H's gross estate under §2044, Treas. Reg. §25.2523(f)-1(f), Examples 10 and 11 provide that the bypass Resulting Trust will *not* be included in W's gross estate pursuant to §2036 or §2038 even though W's beneficial interest in the Resulting Trust is technically a retained interest.

D. Income Tax Analysis

(1) Introduction

[58] For all purposes of this Article, references to the "gross estate" shall be to the "gross estate for federal estate tax purposes under §2031."

(a) As stated above, the General Basis Adjustment Rule under §1014 provides that the income tax basis of property acquired from a decedent is the fair market value of such property at the date of the decedent's death, or, if the decedent's executor so elects, at the alternate valuation date.[59]

(b) In the context of the Deathbed Strategy used in Example #1, upon H's death, the $15 million of assets in H's revocable trust are subject to the General Basis Adjustment Rule and acquire a new basis equal to the fair market value of such assets on the date of H's death.[60]

(2) Basis Step-Up Applies to Lifetime QTIP Trust Assets

(a) What happens to the basis of the assets in the Lifetime QTIP Trust?

(i) Generally, if QTIP property is included in a spouse's gross estate pursuant to §2044, then, pursuant to §1014(b)(10), the QTIP property is considered to have been "acquired from or to have passed from" that spouse, which triggers the General Basis Adjustment Rule for the QTIP property.

(ii) As for QTIP property held in trust, at the moment of the decedent's death, such property is treated, for income tax purposes, as owned by the donor spouse.

(iii) Applying these two concepts, does the taxpayer status for income tax purposes have any effect on the applicability of the General Basis Adjustment Rule?

(b) Taxpayer Status Has No Effect on General Basis Adjustment Rule

(i) In Example #1, when W establishes the Lifetime QTIP Trust, several provisions of Subchapter J of the IRC cause all items of income and deductions from Lifetime QTIP Trust to be taxed to W (i.e., the Lifetime QTIP Trust is a "grantor trust" as to W).

(ii) For example, pursuant to §677(a)(1), the Lifetime QTIP Trust is a "grantor trust" as to W because the income from the Lifetime QTIP Trust must be paid directly to H, who is W's spouse, and such income is therefore "paid to the grantor's spouse without the approval or consent of any adverse party is, or is payable to him or her in the discretion of the grantor or a nonadverse party, or both."

(iii) The Lifetime QTIP Trust can also be considered to be a grantor trust as to W assuming that the actuarial value of her interest in the Resulting Trust exceeds 5% of the overall trust value (which is likely if the Resulting Trust provides her with mandatory income).

(iv) As the Lifetime QTIP Trust is a "grantor trust," Rev. Rul. 85-13, 1985-1 C.B. 184, in effect, concludes that during H's life, W owns the assets of the trust for income tax purposes.

(v) Contrast the above with the purpose of §1014 (also an income tax provision), which is to grant a benefit for assets "acquired from a decedent" - if Rev. Rul. 85-13 stands for the premise that, for "grantor trust" purposes, the grantor (i.e., W) "owns" the property, then, under §1014, does "grantor trust" property actually "pass" from a decedent (i.e., H) since the decedent is not treated as "owning" the property for income tax purposes?

---

[59] Section 1014(a); Treas. Reg. §1.1014-1(a). Note that Treas. Reg. §1.1014-2(b)(2) provides that the General Basis Adjustment Rule applies even if a 706 is not required to be filed.

[60] Because no federal estate taxes are due, the alternate valuation under §2032 is not applicable. Further, even though the assets are owned by H's revocable trust, §1014(b)(2) considers the assets to pass directly from H so, therefore, the General Basis Adjustment Rule applies.

(vi) Stated differently, does Rev. Rul. 85-13 indirectly create an exception to the General Basis Adjustment Rule under §1014(a) for Lifetime QTIP Trusts that are taxed for income tax purposes to the grantor?

(vii) The short answer is that there does not appear to be such an exception.

(I) The phrase "acquiring the property from a decedent" in §1014(a) is explained in §1014(b), which appears to refer to the <u>actual</u> transfer of property as a result of a decedent's death and not to the "income tax" transfer of property.

(II) This conclusion is reinforced by the reference in Treas. Reg. §1.1014-2(b)(2) to the decedent's 706 (or lack thereof): "It is not necessary for the application of this paragraph that an estate tax return be required to be filed for the estate of the decedent or that an estate tax be payable."

(III) If §1014(a) were only to apply to property owned by another for income tax purposes, the issue of the decedent's 706 would be irrelevant – the true test would be whether such assets were taxed to the decedent for income tax purposes, which is not a test under any of the Treasury Regulations under §1014.

(3) Effects of the One-Year Rule

(a) Although there are three exceptions within §1014 to the General Basis Adjustment Rule, for purposes of the Deathbed Strategy, only one exception is pertinent – under §1014(e), there is no basis adjustment for property transferred to the decedent within one year of the decedent's death and which is then bequeathed back to the transferor.[61]

(b) Specifically, §1014(e)(1) provides as follows:

> "(e) Appreciated property acquired by decedent by gift within 1 year of death.
>
> (1) In general. In the case of a decedent dying after December 31, 1981, if—
>
> (A) appreciated property was acquired by the decedent by gift during the 1-year period ending on the date of the decedent's death, and
>
> (B) such property is acquired from the decedent by (or passes from the decedent to) the donor of such property (or the spouse of such donor),
>
> the basis of such property in the hands of such donor (or spouse) shall be the adjusted basis of such property in the hands of the decedent immediately before the death of the decedent.

[61] Treas. Reg. §1.1014-1(c)(1). Also excepted from the General Basis Adjustment Rule are unexercised incentive stock options and options to purchase pursuant to an employee stock purchase plan. Treas. Reg. §1.1014-1(c)(2).

(c) As stated above, the general rule is fairly straightforward – if gifted property passes back to the donor as a result of the death of the recipient within one year of the gift, the General Basis Adjustment Rule does not apply.

(d) However, a more careful reading of the statute may present an "exception-to-the-exception."

(i) The statute refers to property re-acquired by the "donor" of the property.

(ii) Who exactly is the "donor" in this instance – is this to be interpreted literally, i.e., directly to the donor, or is this to be interpreted generally, i.e., directly to the donor or indirectly to the donor through a trust in which the donor is a beneficiary?

(e) Application to Example #1

(i) H is in hospice care and expected to die within a few days.

(ii) The Lifetime QTIP Trust assets will be included in H's gross estate pursuant to §2044. The remainder, however, is not returning directly to W, but, rather, is returning *indirectly* to W in the form of a current interest in a trust (or trusts).

(iii) Therefore, it would appear as if the premise of the Deathbed Strategy falls outside the literal wording of §1014(e)(1).[62]

(f) However, a more in-depth analysis may lead to a different conclusion.

(i) The legislative history to §1014(e) appears to provide for a far more expansive reach than the statutory language.

(ii) Specifically, the legislative history states that,

> "For decedents dying after December 31, 1981, the bill provides that the stepped-up basis rules contained in section 1014 will not apply with respect to appreciated property acquired by the decedent through gift within [one-year] of death (including the gift element of a bargain sale), if such property passes, *directly or indirectly*, from the donee-decedent to the original donor or the donor's spouse. (Emphasis provided.)"[63]

(iii) It is unclear how the phrase "directly or indirectly" is to be interpreted, especially since such language was not adopted in the final statute.

---

[62] *See* Mark R. Siegel, *I.R.C. Section 1014(e) and Gifted Property Reconveyed in Trust,* 27 AKRON TAX J. 33 (2011-2012), at p. 45: "Consistent with the statutory language contained in §1014(e)(1), the legislative history to §1014(e) clearly indicates congressional concern about the situation where the donee-spouse dies within a year of the transfer and leaves the donor-spouse the property outright. The statutory language found in §1014(e)(1) lends support to the argument that the step up in basis is not barred where, rather than returning the property directly to the donor, the donee-spouse instead provides that the property passes in trust for the surviving donor-spouse."

[63] ECONOMIC RECOVERY TAX ACT OF 1981, PL 97-34, 8/13/81, RIA COMREP ¶10,141.009 (Basis of certain appreciated property transferred to decedent by gift within one year of death).

(iv) If the legislative history is applied to interpret the statute, the statutory phrase "acquired from the decedent by (or passes from the decedent to) the donor" would be interpreted to include *indirect* interests for the donor's benefit.

(v) A narrow interpretation is that "indirectly" refers to transfers in trust where the funds will ultimately be distributed outright to the donor, such as if the trust agreement provides that if a particular asset is sold, the sales proceeds are to be distributed outright to the surviving spouse.[64]

(vi) A broader application is that "indirectly" could include a mandatory or discretionary income interest in a trust - if the broader interpretation is applied, then under facts similar to the Deathbed Strategy, the General Basis Adjustment Rule would not apply to the entire Resulting Trust for W.

(g) Since §1014(e) was enacted, the Service has provided little detailed information on how to apply §1014(e)[65] - a search for guidance located only 5 published Private Letter Rulings in which §1014(e) was a primary focus, and, in each such ruling, the Service relied on the "direct or indirect" language from the legislative history in interpreting the scope of §1014(e) (the "1014(e) PLRs").[66]

(i) How best to plan to avoid the 1014(e) PLRs depends on the standard of living of the donor spouse.

(ii) If the donor spouse does not necessarily need full access to the funds, the Resulting Trust for the donor spouse should be prepared as a discretionary trust under which the distribution of income and principal among the donor spouse and the donor spouse's descendants is at the complete discretion of independent trustees.

(iii) Drawn in this manner, it would appear impossible to actuarially determine the "definite" interest in the donor spouse.

(iv) In this instance, with the default rule of §1014(a) applying, and if the portion subject to §1014(e) cannot be actuarially determined, it can be concluded that the §1014(e) portion has no value, so therefore the entire Resulting Trust is subject to the General Basis Adjustment Rule.[67]

(h) Bifurcation rule

---

[64] *See* Siegel, *supra* note 62, at p. 46: "The language may be limited only to situations where the appreciated property is sold and the fiduciary is directed to distribute the proceeds to the donor. For example, in the context of the sale of appreciated property by a trust, the language may be intended to cover the limited situation where the donee created a trust and the trustee of that trust sells the appreciated property and distributes the proceeds to the donor according to the trust agreement. In contrast, the statute may not expressly cover the donee-decedent's testamentary trust funded with the appreciated property with the donor as beneficiary of a life interest or term certain interest."

[65] Scroggin Article, *supra* note 2, at p.4.

[66] Id., *citing* Priv. Ltr. Rul. 9026036 (March 28, 1990); *reversed, in part but not as to §1014(e)*, by Priv. Ltr. Rul. 9321050 (February 25, 1993); Priv. Ltr. Rul. 9308002 (November 16, 1992). Priv. Ltr. Rul. 200101021 (January 8, 2001); Priv. Ltr. Rul. 200210051 (March 8, 2002). Although Private Letter Rulings are binding only on the requesting party, they do provide insight on the Service's position as to a particular issue.

[67] *See* Howard M. Zaritsky, *Tax Planning for Family Wealth Transfers During Life: Analysis With Forms,* ¶8.07[5][c] (THOMSON REUTERS/TAX & ACCOUNTING, 5TH ED. 2013, WITH UPDATES THROUGH MAY 2016) (online version accessed on Checkpoint (www.checkpoint.riag.com). *See also* Lester B. Law and Howard M. Zaritsky, *Basis, Banal? Basic? Benign? Bewildering?*, 49 U. MIAMI HECKERLING INSTITUTE ON ESTATE PLANNING, IV.E.3(d (unpublished) (2015); Steve Akers, *Current Developments and Hot Topics*, pp. 47–48 (June 2014) (available at www.bessemer.com/advisor).

(i) What if, however, the donor spouse must have access to some of the funds - not enough access to require an outright payment of all assets back to the donor spouse, but partial access by means of a mandatory income interest?

(ii) Under the 1014(e) PLRs, the suggestion is made that §1014(e) would apply to any portion of assets in trust where the donor spouse has a definite interest, such as a mandatory income interest.

(iii) Under that scenario, the 1014(e) PLRs infer that §1014(a) and §1014(e) would apply proportionately between the determinable interest for the spouse (i.e., the mandatory income interest) and the other interests in the trust, with the default rule of §1014(a) applying and then excepted by any portions deemed to be subject to §1014(e) (the "Bifurcation Rule").

(iv) Illustrative Example

(I) For example, at 65 years of age, by applying a 2.2% interest rate as determined under §7520 (the "7520 Rate"), the life estate factor for valuing a trust interest is 31% (with a remainder factor of 69%).

(II) At age 75, applying the same 2.2% 7520 Rate, the life estate factor is decreased 21% (and remainder factor is increased to 79%).

(III) Under the Bifurcation Rule, if W, a 75 year old Florida resident, creates a Lifetime QTIP Trust on H's deathbed and, upon H's death, the Resulting Trust is a mandatory income trust for W's lifetime, the entire Resulting Trust would be subject to the General Basis Adjustment Rule under §1014(a), except that a portion of the Resulting Trust equal to the 21% actuarial value of W's income interest is subject to the One Year Rule under §1014(e).[68]

(v) Complexities are added to the Bifurcation Rule if the donor spouse requires more than just the income from the Resulting Trust.

(I) The actuarial calculation when the donor spouse retains the income interest in the Resulting Trust is a simple calculation; complications arise, and an increase in the portion subject to §1014(e) is likely, if the Resulting Trust also provides that the donor spouse is granted a discretionary principal right subject to an ascertainable standard or a "5 and 5" annual withdrawal right (a "5&5 Right").

(II) The reason for the increase in the value of the §1014(e) portion is that both principal rights can be ascertained for valuation purposes (although the valuation process for the discretionary principal interest can be extremely complex).

(III) The better plan is to not include a 5&5 Right and provide that the income and principal distribution provisions be wholly discretionary and not subject to an ascertainable standard.

[68] Although the Bifurcation Rule is inferred within the 1014(e) PLRs, no mention is made as to how to implement the Bifurcation Rule within the trust, i.e., do all appreciated assets receive a pro-rata basis increase totaling 79% of all trust appreciation, are certain assets allocated to the "remainder" so that such assets are the only assets that receive the basis increase, or is there some other mechanism to implement the General Basis Adjustment Rule?

(IV) This should allow the trustees to assert the argument that all discretion in favor of W is "unascertainable" for valuation purposes, which would effectively negate the imposition of §1014(e).[69]

(vi) Is it a certainty that the Bifurcation Rule will be applied?

(I) Not according to a recent Tax Court opinion. In *Estate of Kite*,[70] Mrs. Kite transferred certain stock into a Lifetime QTIP Trust for Mr. Kite seven days before his death on February 23, 1995.

(II) The Lifetime QTIP Trust provided that, upon Mr. Kite's death, the balance of the trust would be held in an income trust for Mrs. Kite's lifetime (i.e., a trust that would qualify for the QTIP election in Mr. Kite's gross estate).

(III) Upon Mr. Kite's death, the Lifetime QTIP Trust was included in his gross estate under §2044.

(IV) From a reading of the opinion, the issues before the Tax Court did not include the applicability of §1014(e); however, Footnote 9 of the opinion stated, "All of the underlying trust assets, including the OG&E stock transferred to Mr. Kite in 1995 [the Lifetime QTIP Trust],[71] received a step-up in basis under sec. 1014."[72]

(V) It was very apparent to all that Mr. Kite died very soon after the creation of the trust, yet the Tax Court stated that the assets in the Lifetime QTIP Trust were all subject to the General Basis Adjustment Rule.

(VI) Query whether the Tax Court,

(VII) neglected to consider §1014(e) in its opinion,

(VIII) the Service neglected to consider the applicability of §1014(e) in its audit of the matter and arguments before the Tax Court, and/or

---

[69] In any event, the addition of a principal distribution power could cause the valuation methodology to fall outside of a standard actuarial calculation involving the 7520 Rate. *See* John A. Bogdanski, *Federal Tax Valuation* ¶ 5.07[4][b][ii] (THOMSON REUTERS/TAX & ACCOUNTING, 1996, WITH UPDATES THROUGH APRIL 2016) (online version accessed on Checkpoint (www.checkpoint.riag.com), *citing* Priv. Ltr. Rul. 9811044 (Dec. 11, 1997), which involved the partition of a trust in which the income beneficiary possessed a discretionary right to receive income and principal for her lifetime, and the Service declined to issue an advance ruling as to the amount of the gift from the beneficiary to the remaindermen on account of the severance, stating that "[S]ince the gift is not an absolute right to distributions of income or principal, it cannot be valued by use of the tables contained in Section 2512. Rather, the value of the gift should be determined in accordance with the general valuation principles contained in [Treas. Reg. §] 25.2512-1." While it may be that such a valuation is not definable, nevertheless, it involves a much more complex approach to valuing the trust interests. *See also* Siegel, *supra* note 62, at p. 50.

[70] T.C. Memo. 2013-43 (2013). For an analysis of the court's order and Rule 155 computations issued in an unpublished opinion on October 25, 2013, *see* Steve R. Akers, *Estate of Kite v. Commissioner*, LISI ESTATE PLANNING NEWSLETTER #2185 (January 21, 2014).

[71] The court loosely refers to "the stock transferred to Mr. Kite" in the quoted sentence from footnote 9. However, when read together with footnote 5 and the accompanying text in the body of the *Kite* opinion, it is clear that the court is referring to the stock transferred to the Lifetime QTIP Trust.

[72] *See* Kerry A. Ryan, *Kite: IRS Wins QTIP Battle but Loses Annuity War*, Tax Notes, 2013 TNT 239-9 (Dec. 12, 2013).

(IX) the Tax Court ignored the 1014(e) PLRs and focused on the literal language of §1014(e) and concluded that, since Mrs. Kite, the donor, did not receive outright ownership of the assets passing from the Lifetime QTIP Trust, the statutory provisions of §1014(e) did not apply.[73]

(4) Continuing Grantor Trust Status for Resulting Trusts

(a) Introduction

(i) If, upon a spouse's death, the testamentary documents provide for a bypass trust, the bypass trust is its own taxpayer for income tax purposes.

(ii) Under a modern drafting approach, the bypass trust would be total discretionary trust for the benefit of either the surviving spouse or the surviving spouse and the descendants of the deceased spouse.

(iii) If, in a particular taxable year, such discretion is not exercised so that there are no distributions carrying out distributable net income, the bypass trust pays all income taxes on its taxable income.

(iv) Although this would result in taxable income being taxed at a potential top federal income tax rate of 43.4% (with additional state income taxes if the trust is subject to state income taxation), this would also mean that 56.6% of all such taxable income (or less, if state income taxes are applicable) would be reinvested into principal.

(v) In an ideal world, it would be extremely income tax advantageous for the bypass trust to be a grantor trust as to the surviving spouse so that *all* federal (and potential state) income tax dollars could remain in the bypass trust.

(b) Resulting Trust is a Grantor Trust

(i) Unlike traditional bypass trusts, upon the donee spouse's death, regardless of whether the Resulting Trust is a bypass trust or QTIP trust, or both, it is possible to structure the Resulting Trust (or Trusts) to be grantor trusts as to the donor spouse.

(ii) This can occur even though the Lifetime QTIP Trust assets have been included in the donee spouse's gross estate under §2044.

(iii) This result is achieved by applying the language of Treas. Reg. §1.671-2(e)(5), which provides, in pertinent part, as follows:

> If a trust makes a gratuitous transfer of property to another trust, the grantor of the transferor trust generally will be treated as the grantor of the transferee trust. However, if a person with <u>a general power of appointment over the transferor trust exercises that power in favor of another trust</u>, then such person will be treated as the grantor of the transferee trust, even if the grantor of the transferor trust is treated as the owner of the transferor trust under subpart E of the Internal Revenue Code. (Emphasis added.)

[73] Note, however, that there are further potential issues with the applicability of §1014(e), and, in particular, the disposition of assets that could potentially be subject to the provisions of §1014(e)(2). *See* Scroggin Article *supra* note 2, at pp. 8-10.

(iv) Pursuant to this Regulation, a change in the taxpayer for income tax purposes occurs only if someone other than the grantor spouse possesses a general power of appointment over the particular trust and actually exercises it in favor of another trust.

(v) Recall that prior to the introduction of §2056(b)(7) under the Economic Recovery Tax Act of 1981, the primary manner in which a surviving spouse's terminable interest could qualify for the marital deduction is if the surviving spouse were granted a general power of appointment over the trust principal.

(vi) The theory for this was that the general power of appointment granted the spouse virtual ownership of the property.[74]

(vii) Treas. Reg. §1.671-2(e)(5) follows the same logic - if the donee spouse was granted a general power of appointment and exercised it, the donee spouse would have actual ownership and would have appointed the property however he/she pleased; for this reason, he/she should become the "grantor" of the property. However, with a QTIP election, the effect is a "fiction" in terms of actual control.

(viii) It is possible to qualify a trust for the QTIP election even if the donee/deceased spouse only was given the income from the trust with no discretionary principal or the granting of a testamentary limited power of appointment.

(ix) For this reason, since the donee/deceased spouse lacks actual control over the Lifetime QTIP Trust property, there should be no shift in grantor status.[75]

(x) Therefore, as a result of inter-vivos planning, the scenario is created under which a Resulting Trust that is bypass trust can be exponentially enhanced by the ability to retain the income tax dollars within the trust.[76]

(c) One final benefit to this analysis – there is no comparable rule to the One Year Rule of §1014(e) with respect to Treas. Reg. §1.671-2(e)(5) and "grantor trust" status. Therefore, even if the donee spouse dies within one day after the Lifetime QTIP Trust has been created, the provisions of Treas. Reg. §1.671-2(e)(5) should apply as to the Resulting Trust.

E. Creditor Protection

---

[74] Richard B. Stephens, Guy B. Maxfield, Stephen A. Lind, & Dennis A. Calfee, *Federal Estate and Gift Taxation*, ¶5.06, *citing* S. Rep. No. 1013, 80th Cong., 2d Sess. 1163, 1238 (1948), reprinted in 1948-1 CB 285, 342 (THOMSON REUTERS/WG&L, 9TH ED. 2013, WITH UPDATES THROUGH JUNE 2016) (accessed on Checkpoint (www.checkpoint.riag.com)).

[75] *See* Pennell, *Myths, Mysteries, & Mistakes*, sec. 3. Note that Treas. Reg. §1.671-2(e)(5) was released in T.D. 8831 on August 23, 1999, or 17 years after Congress passed the QTIP legislation, so if Treasury intended to include QTIP trusts as part of this Regulation, it would have done so. Since Treasury did not include references to QTIP trusts within Treas. Reg. §1.671-2(e)(5), electing QTIP treatment does not convert "grantor trust" status.

[76] As to the bypass trust, the benefits include having the donor spouse pay the income tax on the income earned by the bypass trust, which enhances the bypass trust by preserving the assets that would otherwise have been used to pay such income taxes, i.e., "supercharging" the bypass trust. *See* Mitchell M. Gans, Jonathan G. Blattmachr, Diana S. C. Zeydel, *Supercharged Credit Shelter Trust*,SM 21 PROB. & PROP. 52 (July/Aug. 2007) and Jonathan G. Blattmachr, Mitchell M. Gans and Diana S. C. Zeydel, *Supercharged Credit Shelter Trust*SM *versus Portability*, 28 PROB. & PROP. 10 (March/April 2014). *See also* American Bar Association Section on Real Property Trust and Estate Law, Estate Tax Committee of the Income and Transfer Tax Group, *Portability – The Game Changer*, DISTRIBUTED AT 47 U. MIAMI HECKERLING INSTITUTE ON ESTATE PLANNING, Jan. 2013 (available at http://apps.americanbar.org/dch/committee.cfm?com=RP512500) and Richard S. Franklin and Lester B. Law, *Portability's Role in the Evolution Away from Traditional Bypass Trusts to Grantor Trusts*, 37 BLOOMBERG BNA, TAX MANAGEMENT'S ESTATES, GIFTS AND TRUSTS JOURNAL 135 (No. 2, March-April 2012).

(1) Introduction

(a) In addition to tax planning, an additional key to the Deathbed Strategy is grounded in state law.

(b) Certain asset protection features are available if all trusts created under the Lifetime QTIP Trust are governed under the laws of either an DAPT state or a Quasi-DAPT State.

(2) Creditor Protection During H's Lifetime

(a) As described above, the Lifetime QTIP Trust is an irrevocable trust under which W, as the settlor, has not retained any current interests.

(b) For the duration of H's lifetime, H is the sole current recipient of trust income and, depending on the trust provisions, will be the sole recipient of discretionary principal distributions.

(c) As is the case with most irrevocable trusts, the Lifetime QTIP Trust will likely include a "spendthrift clause," which provides, in general, that the holder of a beneficial interest in the trust may not transfer or assign such interest and that such interest may not be used to satisfy the obligations of any creditors of the interest holder.

(d) It is important to include a spendthrift provision because some states mandate spendthrift protection while other states require it to be part of the trust agreement.[77]

(e) In Example #1, because H did not create the trust, H's interest in the Lifetime QTIP Trust should be protected from H's creditors (but this protection ends once income is actually

[77] Under the Uniform Trust Code ("UTC"), spendthrift protection must be specifically elected. The approach under the UTC is one of negative inference, as UTC §501 provides that, to the extent a beneficiary's interest is not subject to a spendthrift provision, the court may authorize a creditor or assignee of the beneficiary to reach the beneficiary's interest by attachment of present or future distributions to or for the benefit of the beneficiary or other means. The UTC then explains the nature of a "spendthrift provision" in UTC §502, which provides that, (a) a spendthrift provision is valid only if it restrains both voluntary and involuntary transfer of a beneficiary's interest; (b) a term of a trust providing that the interest of a beneficiary is held subject to a "spendthrift trust," or words of similar import, is sufficient to restrain both voluntary and involuntary transfer of the beneficiary's interest; and (c) a beneficiary may not transfer an interest in a trust in violation of a valid spendthrift provision and, except as otherwise provided in this [article], a creditor or assignee of the beneficiary may not reach the interest or a distribution by the trustee before its receipt by the beneficiary. This trend is carried forward by states that adopt the UTC, e.g., FLA. STAT. §§736.0501 and 736.0502. In other states, spendthrift protection is the default, e.g., N.Y. EST. POWERS & TRUSTS §7-3.1(b)(2), which provides that "All trusts, custodial accounts, annuities, insurance contracts, monies, assets, or interests described in subparagraph one of this paragraph shall be conclusively presumed to be spendthrift trusts under this section and the common law of the state of New York for all purposes, including, but not limited to, all cases arising under or related to a case arising under sections one hundred one to thirteen hundred thirty of title eleven of the United States Bankruptcy Code, as amended."

distributed to H because H's income right is mandatory and, once distributed to H, the income then becomes H's property).[78]

(f) The use of the spendthrift provision for H's income interest is a standard feature that would be found in almost every irrevocable trust.

(3) H's Death – Protection for W

(a) Where the Deathbed Strategy deviates from the norm is upon H's death.

(b) Upon H's death, as set forth above, the Lifetime QTIP Trust provides for an interest in W in the Resulting Trust, which is a discretionary trust interest for W (in the form of a bypass trust), a mandatory income trust interest for W (in the form of a QTIP trust), or both.

(c) At first glance, once the Resulting Trust is created, W, who created the Lifetime QTIP Trust, now has a beneficial interest in a trust created under the Lifetime QTIP Trust.

(d) In other words, the Resulting Trust is technically an DAPT for W's benefit and, as previously stated, most states do not provide creditor protection for such self-settled interests.

(e) As the objective is to provide creditor protection for W, the Lifetime QTIP Trust must be established in either an DAPT State or a Quasi-DAPT State.

(f) In Example #1, because W established the Lifetime QTIP Trust under Florida law, and since Florida is a Quasi-DAPT State, W's interest in the Resulting Trust will be protected from the claims of her creditors after H's death.[79]

(g) No One-Year Rule Equivalent

---

[78] Although beyond the scope of this article, questions abound as to certain protection afforded to discretionary distributions as to exception creditors. For example, pursuant to NEV. REV. STAT. §163.419(4), unless otherwise provided in the trust instrument, regardless of whether a beneficiary has an outstanding creditor, a trustee of a discretionary interest may directly pay any expense on the beneficiary's behalf and may exhaust the income and principal of the trust for the benefit of such beneficiary. The protection afforded by this provision is all-encompassing and is not subject to the rights of any exception creditor, such as a spousal payments or child support. *See* Steven J. Oshins, *9th Annual Dynasty Trust State Rankings Chart* (www.oshins.com/images/Dynasty_Trust_Rankings.pdf) and *11th Annual Domestic Asset Protection Trust State Rankings Chart* (www.oshins.com/images/DAPT_ Rankings.pdf). Contrast this view with FLA. STAT. §736.0504(2), which provides that if a trustee may make discretionary distributions to or for the benefit of a beneficiary, a creditor of the beneficiary may not compel a distribution that is subject to the trustee's discretion, or attach or otherwise reach the interest, if any, which the beneficiary might have as a result of the trustee's authority to make discretionary distributions to or for the benefit of the beneficiary. The Florida Second District Court of Appeal, in Berlinger v. Casselberry, 133 So.3d 961 (Fla. 2nd Dist. Ct. App. 2013), distinguished between attaching the interest and attaching distributions from the interest when it upheld an ex-spouse's right as an exception creditor to attach discretionary distributions from the interest. *See also* Barry A. Nelson, *Bacardi on the Rocks*, 86 FLA. BAR J. 21 (March 2012); Barry A. Nelson, *Bacardi: The Hangover*, 88 FLA. BAR J. 40 (March 2014).

[79] FLA. STAT. §736.0505(3) provides:

> (3) Subject to the provisions of s. 726.105, for purposes of this section, the assets in:
>
> (a) A trust described in s. 2523(e) of the Internal Revenue Code of 1986, as amended, or a trust for which the election described in s. 2523(f) of the Internal Revenue Code of 1986, as amended, has been made; and
>
> (b) Another trust, to the extent that the assets in the other trust are attributable to a trust described in paragraph (a), shall, after the death of the settlor's spouse, be deemed to have been contributed by the settlor's spouse and not by the settlor.

(i) Most importantly, unlike §1014(e), state law does not impose a One Year Rule.

(ii) As the One Year Rule is purely a tax concept, none of the DAPT States nor the Quasi-DAPT States establishes a mandatory minimum period of duration for the donee spouse's interest to merit the creditor protection feature relating to the donor spouse's interest in the Resulting Trust.

(h) Hence, W's creation of the Lifetime QTIP Trust on H's deathbed does not exclude the protection of W's interest in the Resulting Trust from the claims of her creditors.[80]

(4) The asset protection feature of the Quasi-DAPT Statutes is applicable so long as the donor spouse makes a timely and proper gift tax QTIP election.[81]

(a) If the donee spouse dies before the QTIP election is due to be timely made, a timely election can nevertheless be made by his/her executor and such election is retroactive for federal transfer tax purposes.

(b) Because the Quasi-DAPT Statute is linked directly to the QTIP election, presumably the protection provided by the Quasi-DAPT Statute should likewise be retroactive.

(5) No Effect on Grantor Trust Status

(a) It is important to acknowledge that, while a Quasi-DAPT Statute "switches" the settlor for state law purposes only, such statutes have no effect on "grantor trust" status for federal income tax purposes.

(b) For example, the Florida Quasi-DAPT Statute (Fla. Stat. §736.0505(3)) provides that the donee spouse is deemed to be the settlor but only *after* the donee spouse's death.[82]

(c) As described above, Treas. Reg. §§1.671-2(e)(1) and (2) provide that the donor spouse is the "grantor" for income tax purposes when the trust is created and continues as the "grantor" even after the death of the donee spouse, unless, as set forth in Treas. Reg. §1.671-2(e)(5), the donee spouse is given, and exercises, a general power of appointment.[83]

(d) No reference is made within Treas. Reg. §1.671-2(e) to the effect of state law on "grantor" status, so it can be concluded that state law has no effect on such status.

---

[80] Also consider that the asset protection afforded by the Quasi-SST Statutes is seemingly not limited to residents of the particular state having such a statute. For example, a resident of Georgia, which is neither an SST State nor a Quasi-SST State, could take steps to properly establish a nexus to Florida when creating a Lifetime QTIP Trust, such as using a Florida trustee and using Florida for the trust's situs. This nexus would provide a basis for using Florida law, thereby allowing the Georgia resident to take advantage of the creditor protection benefits of Florida's Quasi-SST Statute.

[81] Likewise, the QTIP election for transfer tax purposes causes the donee spouse to be the deemed transferor for gift, estate and GST tax purposes. *See* Ubiquitous *supra* note 6, at ¶ 1600.6[B].

[82] Most of the Quasi-SST Statutes invoke the protection only after the donee spouse's death and ignore any termination of the donee spouse's interest during his/her lifetime. Exceptions to this general rule include Maryland, in MD. CODE, EST. & TRUSTS §14.5-1003(a)(2)(iii) ("The individual's interest in the trust income, trust principal, or both follows the termination of the spouse's prior interest in the trust.); and Michigan, in the preamble to MICH. COMP. LAWS §700.7506(4) ("…that follows the termination of the individual's spouse's prior beneficial interest…").

[83] Moreover, most of the Quasi-SST Statutes specifically limit the statute's applicability to the particular state statute which a clause such as "for purposes of this section." That being said, the Maryland, Michigan and Oregon statutes are not so specifically narrow, but it is unlikely that such a statute would be deemed by the Service to have an effect on grantor trust status.

(6) Negating a §2041 Argument

(a) Lifetime QTIP Trust planning is not new – it has been in existence for as long as the QTIP election has been the law. However, due to enhanced awareness of creditor issues, practitioners began to focus on a new potential wrinkle to the transfer tax consequences of Lifetime QTIP Trust planning.

(b) Variation on Example #1 – the §2041 Argument

(i) Suppose in Example #1 that W is a resident of New York and not Florida.

(ii) As stated above, Treas. Reg. §25.2523(f)-1(f), Examples 10 and 11 provide clear guidance that the Resulting Trust established as a bypass trust for W's lifetime is not included in W's gross estate upon her death.

(iii) However, as described above, because the Resulting Trust is created under a trust document created by W, and because the Resulting Trust benefits W, the Resulting Trust is technically an DAPT as to W, which means that W's creditors can potentially reach a portion (or all) of the Resulting Trust.

(iv) Recall that under §2041(b)(1), the basic definition of a "general power of appointment" is a power which is exercisable in favor of the decedent, his/her estate, his/her creditors or the creditors of his/her estate.

(v) If W's creditors can reach a portion of a Resulting Trust, would that portion then be includible in W's gross estate under §2041?

(vi) Support for excluding such property from W's gross estate cannot be found in Treas. Reg. §25.2523(f)-1(f), Examples 10 and 11 because those Examples do not contemplate gross estate inclusion under §2041.

(c) One alternative for avoiding this concern is to establish the Resulting Trust in either an DAPT State or a Quasi-DAPT State.

(i) If creditors cannot reach the Resulting Trust, there should be no potential §2041 gross estate inclusion of the Resulting Trust.

(ii) In the actual facts of Example #1, the §2041 concern is avoided because the Lifetime QTIP Trust is established under Florida's Quasi-DAPT Statute.[84]

(7) Interaction with Applicable Fraudulent/Voidable Statutes

(a) Introduction

(i) The creditor protection feature of the Quasi-DAPT Statutes is not elective or discretionary (i.e., it applies if a Lifetime QTIP Trust is established, a timely gift tax QTIP election is made and the donor spouse retains a current beneficial interest in any Resulting Trust).

(ii) However, there is one additional requirement in order to invoke this protection - the transfer may not be in violation of the particular state's fraudulent transfer laws.

---

[84] *See* Ubiquitous *supra* note 6 at ¶ 1602.1[B].

(b) Under the law of most states, a transfer made or an obligation incurred by a debtor is voidable as to a creditor if the debtor made the transfer or incurred the obligation with actual intent to hinder, delay, or defraud any creditor of the debtor.

(c) Such voidability is present regardless of whether the creditor's claim arose before or after the transfer was made or the obligation was incurred.[85]

(d) Badges of Fraud

(i) In terms of what is "actual intent," such laws provide a non-exclusive list of examples often referred to as the "badges of fraud."

(ii) Some of the "badges of fraud" include the following:

(I) the debtor retained possession or control of the property transferred after the transfer;

(II) the transfer or obligation was disclosed or concealed;

(III) before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit;

(IV) the transfer was of substantially all the debtor's assets; and

(V) the debtor removed or concealed assets.[86]

(iii) As a result of such fraudulent transfer statutes, if W is determined to have had the intent to avoid a specific creditor, the transfer of property to the Lifetime QTIP Trust could be reversed.

(iv) Not only would the transferred assets be available for W's creditors, but any tax advantages achieved by the transfer would be negated.

(v) This is not to say that every transfer involving an asset protection technique is done with an intent to hinder, delay or defraud; on the contrary, if the donor spouse had no pending creditor issues, fraudulent transfer statutes *should* not be a concern.

(e) Deathbed Strategy and Future Creditors

(i) What if, however, after engaging in the Deathbed Strategy, W is involved in a transaction from which legal action is commenced, the result of which is a judgment against W. Assume that W has no assets available to satisfy the judgment - to what degree does the Deathbed Strategy intersect with the fraudulent transfer law as to *future* creditors?

(ii) In some Quasi-DAPT Statutes, the intersection is direct - consider the opening language of the North Carolina Quasi-DAPT Statute: "Subject to the Uniform Voidable Transactions Act, Article 3A of Chapter 39 of the General Statutes…"[87]

---

[85] *See generally* UFTA/UVTA §4(a)(1).

[86] *See generally* UFTA/UVTA §4(b).

[87] N.C. GEN. STAT. §36C-5-505(c).

(iii) The Deathbed Strategy involves taking advantage of the creditor protection laws of either an DAPT State or a Quasi-DAPT State, thereby presenting a definite and acknowledged asset protection element to the transaction.

(iv) Query: is this "asset protection" intent enough to signify the "actual" intent needed to invoke fraudulent transfer law?

(I) For example, under Example #1, W transfers all of her $15 million of assets into the Lifetime QTIP Trust, and soon thereafter H dies, with the Lifetime QTIP Trust providing for the balance to pass into a discretionary bypass Resulting Trust and a QTIP Resulting Trust.

(II) W has an interest in both Resulting Trusts – in effect, W will have transferred all of her assets into the Lifetime QTIP Trust, which appears to satisfy one of the "badges of fraud."

(III) Even though she had no creditor issues at the time that she created the Lifetime QTIP Trust, has W now run afoul as to a future creditor because she violated one of the "badges of fraud"?

(IV) This is unclear and this risk should not be understated.

(f) Potential Effect of the UVTA's New §10 and the UVTA Official Comments

(i) The creditor issue is further enhanced if a state adopts the UVTA and its courts apply the new Comments issued as part of the UVTA to the application of its UVTA law.

(ii) If H and W are not residents of either an DAPT state or a Quasi-DAPT State, the ability to implement the Deathbed Strategy may be hampered.

(iii) Section 10(b) of the UVTA (which is not present in the UFTA) provides as follows:

> "(b) A claim for relief in the nature of a claim for relief under this [Act] is governed by the local law of the jurisdiction in which the debtor is located when the transfer is made or the obligation is incurred."

(iv) Under pre-UVTA law, many individuals sought to achieve greater asset protection by creating DAPTs, and, if the individual's state of residence had not enacted DAPT legislation (the "Resident State"), the individual would create the DAPT in an DAPT State.

(v) If a judgment were rendered against the individual in the Resident State, and if the creditor sought to enforce the judgment in the DAPT State, often a conflict of laws issue would arise, with the DAPT State denying the enforcement of the judgment due to the fact that the DAPT State allows the creation and protections afforded to DAPTs.[88]

(vi) In adopting the UVTA, the Uniform Law Commission was not shy about its purpose with respect to DAPTs – it wished to eliminate them.

---

[88] Many articles have been written on this topic; for this particular purpose, the authors cite to George D. Karibjanian, Gerard "J.J." Wehle, Robert L. Lancaster and Michael A. Snerringer, *The New Uniform Voidable Transactions Act: Good for the Creditors' Bar, But Bad for the Estate Planning Bar? - Part Two,* LISI ASSET PROTECTION PLANNING NEWSLETTER #317 (March 15, 2016) ("UVTA I") and George D. Karibjanian, Gerard "J.J." Wehle and Robert L. Lancaster, *History Has Its Eyes on UVTA - A Response to Asset Protection Newsletter #319*, LISI ASSET PROTECTION NEWSLETTER #320 (April 18, 2016) ("UVTA II").

(I) For example, in his "White Paper" on the UVTA, Uniform Law Commission Reporter Kenneth C. Kettering stated,

> The avoidance laws of some jurisdictions are substantially debased by comparison with the UVTA. That is notably so in "asset havens" that have eviscerated, or completely expunged, their avoidance laws, commonly as part of a package of local laws that facilitate the local formation of so-called "asset-protection trusts" by persons seeking to shield their assets from their creditors…Section 10 reflects the committee's conclusion, which was to include no escape hatch in the statutory text. It addresses asset tourism through a comment stating that a debtor's "principal residence," "place of business," or "chief executive office" should be determined on the basis of genuine and sustained activity, not on the basis of artificial manipulations.[89]

(II) In the seventh paragraph to new Comment 8 ("Paragraph 7") to the UVTA, the Uniform Law Commission set forth its intentions regarding traveling to a particular DAPT State to create an DAPT:

> By contrast, if Debtor's principal residence is in jurisdiction Y, which also has enacted this Act but has no legislation validating such trusts, and if Debtor establishes such a trust under the law of X and transfers assets to it, then the result would be different. Under §10 of this Act, the voidable transfer law of Y would apply to the transfer. If Y follows the historical interpretation referred to in Comment 2, the transfer would be voidable under §4(a)(1) as in force in Y.[90]

(III) The effect of this particular provision and others[91] is clear-cut - if the donor spouse's Residence State has adopted the UVTA and is not either an DAPT State or a Quasi-DAPT State, and if the Lifetime QTIP Trust is established in either an DAPT State or a Quasi-DAPT State, then, because the Resulting Trust is an DAPT, the transfers to the Lifetime QTIP Trust are voidable *per se*.

(IV) Thus, the assets are not free from the claims of the donor spouse's creditors, which can include *future, presently unknown* creditors.

(V) The interpretation of this Comment cannot be clearer - the effect of this interpretation increases the risk of gross estate inclusion of the bypass Resulting Trust in the donor spouse's estate.

---

[89] UVTA I, *supra* note 88, at p. 3, *citing* Kenneth C. Kettering, *The Uniform Voidable Transactions Act; or, the 2014 Amendments to the Uniform Fraudulent Transfer Act*, 70 THE BUSINESS LAWYER 778 (Summer 2015) at p. 800-1.

[90] UVTA I, *supra* note 88, at p. 4.

[91] Other Comments have an effect on the ability of creditors to reach an SST. *See, for example*, Comment 2 to UVTA §4.

(VI) Such a result clearly imperils the effectiveness of the Deathbed Strategy for this particular donor spouse.[92]

(VII) Establishment in Quasi-DAPT Jurisdiction if the Settlor Lives in such Quasi-DAPT Jurisdiction.

(A) The concerns under Paragraph 7 as to future creditors are not, however, present if the Lifetime QTIP Trust is established by a resident of one of the Quasi-DAPT Jurisdictions under the law of his or her home state.

(B) Consider this passage from Paragraph 7 that immediately precedes the above-quoted provision:

> If an individual Debtor whose principal residence is in X establishes such a trust and transfers assets thereto, then under § 10 of this Act the voidable transfer law of X applies to that transfer. That transfer cannot be considered voidable in itself under § 4(a)(1) as in force in X, for the legislature of X, having authorized the establishment of such trusts, must have expected them to be used. (Other facts might still render the transfer voidable under § 4(a)(1).)[93]

(C) Therefore, so long as the debtor did not violate other provisions of the UVTA in creating the Lifetime QTIP Trust, the transfer is not voidable *per se*.

(8) Application of §1014(a) and Creditor Protection to Example #1

(a) No Technique Employed

(i) To summarize the effect of §1014(a) and applying the particular creditor protection statutes, suppose that, in Example #1, W does not create the Lifetime QTIP Trust.

(ii) Upon H's death, W will have a beneficial interest in a testamentary QTIP trust and a traditional bypass trust created by H's revocable trust, and she will continue to own her $15 million of assets in her revocable trust.

(iii) H's entire gross estate will be subject to the General Basis Adjustment Rule of §1014(a).

(iv) W's beneficial interests created in the testamentary trusts under H's revocable trust would be protected from W's creditors by a standard spendthrift provision.[94]

(v) However, W's revocable trust with her $15 million of assets remains with a zero basis for income tax purposes and subject to the claims of her creditors.

---

[92] As set forth in both UVTA I and UVTA II, *supra* note 88, Comments are not adopted by states as part of their respective laws and are only intended to provide the Uniform Law Commission's interpretation of a particular provision; however, many states will rely on the Comments, and it is with that background that great attention must be paid to the Comments.

[93] Comment 8 to UVTA §4.

[94] Creditors are, however, likely able to reach the income of the QTIP once distributed to W.

(b) Deathbed Technique is Employed

(i) If, however, W creates and funds the proposed Lifetime QTIP Trust with $11.70 million (and makes a timely gift tax QTIP election), upon H's death, this amount passes to the grantor bypass Resulting Trust under the Lifetime QTIP Trust.

(ii) Assuming that W's beneficial interests in the grantor bypass Resulting Trust are limited to discretionary distributions by an independent trustee, the authority for which is not subject to an ascertainable standard, the General Basis Adjustment Rule should also apply to adjust the basis of this $11.70 million of assets to the fair market value of such assets on H's death.

(iii) Additionally, the grantor bypass Resulting Trust is protected from W's creditors as a spendthrift trust created by H (i.e., as a result of Florida's Quasi-DAPT Statute).

(iv) The formula in H's revocable trust adjusts automatically to fund the testamentary QTIP trust under his revocable trust with H's $15 million of assets (i.e., because H's AEA was applied to the Lifetime QTIP Trust).

(v) A standard spendthrift provision protects the testamentary QTIP trust is protected from W's creditors.[95]

(vi) Therefore, in this permutation, $26.70 million of the entire $30 million estate receives an automatic basis adjustment to fair market value on H's death and is protected from W's creditors.

(c) Fully Funding the Lifetime QTIP Trust

(i) Alternatively, if W funds the Lifetime QTIP Trust with her entire $15 million of zero basis assets and she makes a timely gift tax QTIP election, upon H's death the $15 million is split between a grantor bypass Resulting Trust and the secondary QTIP Resulting Trust.

(ii) As indicated above, the basis of the $11.70 million of assets transferred to the grantor bypass Resulting Trust will be adjust to fair market value on H's death.

(iii) The $3.3 million of assets transferred to the secondary QTIP Resulting Trust will likewise receive a basis adjustment (which is potentially subject to the Bifurcation Rule eliminating a basis adjustment for the portion representing W's mandatory income interest).

(iv) Both Resulting Trusts will be protected from W's creditors pursuant to the Florida Quasi-DAPT Statute as spendthrift trusts deemed to have been created by H.

(v) The formula in H's revocable trust will again adjust automatically to fund the testamentary QTIP trust under his revocable trust with H's $15 million of assets.

(vi) Therefore, in this permutation, at least $29.3 million[96] of the entire $30 million estate (and possibly the entire estate if the Bifurcation Rule does not apply) receives an automatic basis adjustment to fair market value on H's death.

---

[95] As previously stated, although the entire testamentary QTIP trust would be protected, once the income is distributed to W, the income in W's hands is now available for W's creditors.

[96] If the $3,300,000 million passing to the secondary QTIP Resulting Trust is subject to the Bifurcation Rule, then, assuming that W is 75 years of age and a 2.2% 7520 Rate, 21% of this trust, or $693,000, is subject to §1014(e) and receives no basis adjustment. The remaining portion of the secondary QTIP Resulting Trust, or $2,607,000, plus the $11,700,000 million grantor bypass Resulting Trust and H's $15,000,000 estate all receive an automatic basis adjustment.

(vii) In addition, regardless of the potential application of the Bifurcation Rule, the entire $30 million estate is protected from W's creditors.[97]

F. Plan in Advance for Deathbed Lifetime QTIP Trust

(1) Advance Planning

(a) If the discovery of a spouse's terminal illness is sudden and death is truly imminent, there may not be sufficient time prior to such spouse's death to draft the necessary paperwork and complete the asset transfers into the Lifetime QTIP Trust.

(b) For this reason, consider planning in advance and creating the Deathbed Strategy from within the couple's current estate planning documents.

(2) Application to Example #1

(a) In the context of Example #1, each of W's and H's revocable trusts could have provisions that trigger the establishment of the Lifetime QTIP Trust upon a release of the right to revoke all or a portion of the particular revocable trust (the "Release").

(b) Suppose that W's revocable trust has provisions in it that provide that if W executes a Release, the assets becomes subject to provisions contained in the revocable trust that qualify as a Lifetime QTIP Trust for H.

(c) When such a deathbed situation arises, a one page Release could be quickly signed by the donor spouse, thereby switching to the Lifetime QTIP Trust arrangement.

(d) Such provisions can be added to the revocable trusts for married persons (or a joint revocable trust) by bundling the Lifetime QTIP Trust provisions as a separate article within said revocable trust. The revocable trust can contain a "triggering" mechanism such as the following:

> If, at any time, the Settlor releases the right under Paragraph ___ to amend or revoke this Declaration (the "Exercise"), the property held under this Declaration subject to such Exercise shall, as of the date of the Exercise, be disposed of as provided in Article ___ of this Declaration. The Exercise may encompass all or a portion of this Declaration. The Exercise shall be effected by a written instrument executed with the same formalities as required for the execution of any amendment to this Declaration and shall be delivered to the then-acting Trustee of this Declaration.

[97] A couple of planning ideas to consider: (i) the secondary QTIP Resulting Trust could allow the independent trustee to have broad authority to distribute assets back outright to W without creating any adverse transfer tax consequences. *See generally* Howard M. Zaritsky, *Tax Planning for Family Wealth Transfers During Life: Analysis With Forms,* ¶3.07 (THOMSON REUTERS/TAX & ACCOUNTING, 5TH ED. 2013, WITH UPDATES THROUGH MAY 2016) (online version accessed on Checkpoint (www.checkpoint.riag.com)). Therefore, if the §1014(e) analysis as outlined herein is incorrect, or if the asset protection advantages of the Resulting Trust are not of a high concern to W, the independent trustee could distribute these assets back to W if the independent trustee determined that to be appropriate; and (ii) the testamentary QTIP under H's revocable trust could also have a clause granting an independent trustee to have broad authority to distribute assets to W. In the context of Example 1, the testamentary QTIP trust is neither exempt from estate taxes at W's death or exempt from GST taxes, but it is protected from the claims of W's creditors with a spendthrift clause. If the independent trustee thought it was appropriate, assets of the testamentary QTIP could be distributed out to W so that she has some assets in her individual name and control without jeopardizing the automatic basis adjustment that would be available for $29.3 million of the aggregate estate. This possibility may give W more comfort in implementing the Deathbed Strategy.

(e) In effect, the exercise provisions would be analogous to disclaimer provisions – i.e., they remain dormant unless the spouse who would be the surviving spouse decides to execute the plan.

(f) In addition, depending on the applicable state law, the revocable trust should allow an agent under a durable power of attorney to implement the Release and the settlor's durable power of attorney should authorize the agent to implement such Releases.[98]

(g) Notwithstanding the provisions under applicable state law regarding the formalities of executing documents relating to testamentary dispositions, it is highly recommended that, at a minimum, the Release be notarized.

(h) Since notarizations require the insertion of the date of notarization, the notarial clause can act as a validation that the Release was executed prior to the death of the donee spouse.

G. Conclusion

(1) The Deathbed Strategy offers significant rewards, particularly for individuals residing in one of the 21 states with Quasi-DAPT Statutes (16 Quasi-DAPT States and 5 DAPT States with Quasi-DAPT Statutes), but the strategy also carries risks.

(2) Implementation of the strategy should be carefully considered and discussed with the clients, as the strategy involves the relinquishment of full fee ownership of assets by the donor spouse.

(3) The strategy is potentially subject to reduced income tax benefits and, depending on the domicile of the donor spouse, could be severely hampered if the donor spouse's Residence State adopts the UVTA and the donor spouse crosses state lines to form the lifetime QTIP in DAPT State or Quasi-DAPT State.

(4) However, for those clients who fit within the parameters and who are not risk adverse, the strategy can provide significant income tax and creditor protection advantages.

[98] For example, while under Florida law, an attorney-in-fact may not create, amend or revoke a Will, FLA. STAT. §709.2202(1)(b) provides that the attorney-in-fact can, with respect to a trust created by or on behalf of the principal, amend, modify, revoke, or terminate the trust, but only if the trust instrument explicitly provides for amendment, modification, revocation, or termination by the settlor's agent.