

# Memorandum

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**TO:** All Tax Professionals

**FROM:** The Tax and Wills, Trusts & Estates Practice Group of Brach Eichler LLC

**DATE:** October 21, 2013

**SUBJECT:** IRS Guidance Plan for Estates: Electing QTIP Trust with Portability

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For the 2013-2014 plan year, the Internal Revenue Service (IRS) has only one (1) new item on its priority guidance plan related to trusts and estates: a project exploring the validity of qualified terminable interest property (QTIP) trust elections in portability-only returns. The project outcome may answer some questions created by Revenue Procedure 2001-38, issued on June 11, 2001, by clarifying whether smaller estates can qualify for the marital deduction through a QTIP trust while also electing portability.

A QTIP trust is a trust that allows a spouse to give a life estate in property to his or her spouse (“donee spouse”) and choose the remainder beneficiaries while still utilizing the marital deduction if the following requirements are met: (1) The donee spouse has a lifetime right to all of the income from the gift; (2) all income is payable to the donee spouse annually or more often; (3) no one (including the donee spouse) has a power to appoint the principal or income other than to the donee spouse during the donee spouse’s life; and (4) the donor elects to use the qualified terminable interest rule as to all, or a “specific portion,” of the property. The property held in the QTIP trust would be included in the donee spouse’s gross estate for Federal estate tax purposes.

In Revenue Procedure 2001-38, the IRS addressed a situation in which a predeceased spouse’s estate made an unnecessary QTIP election that did not reduce the estate tax liability of the estate. The QTIP election was disregarded because it was not necessary to reduce the estate tax liability to zero. Consequently, there is a concern that a small estate (below the Federal exemption amount of \$5,250,000) would not be able to use the QTIP election. This Rev. Proc.

was issued for the purpose of helping taxpayers avoid wasting their estate tax exclusion; however, with permanent portability now available, this Rev. Proc. might instead limit the ability of a married couple to use a trust upon the first spouse's death and garner the income tax benefits of portability (mainly, a step-up in income tax basis).

**Sample fact pattern:** Assume Gloria, a New Jersey resident, passed away in 2013. At the time of her passing, Gloria was married and had two children from her prior marriage and two stepchildren from her husband's prior marriage. She had made no taxable gifts during her lifetime, and now, her estate is valued at approximately \$2,675,000. There was no anticipated Federal estate tax, but Gloria had wanted to do New Jersey tax planning. Specifically, her Will established a credit shelter trust funded up to the New Jersey exemption amount of \$675,000 (to avoid NJ estate tax) with the balance of the \$2 million funding a QTIP trust for her spouse. Gloria had chosen a QTIP trust in order to receive the marital deduction while still controlling to whom her assets were distributed after her husband passes away. The QTIP trust was drafted so that, upon her husband passing away, the remaining assets would be divided among her two children and two stepchildren equally. A Federal estate tax return is then filed claiming portability of \$4,575,000 (\$5,250,000, the Federal exemption in 2013, reduced by \$675,000).

**Risk:** It was not necessary to make the QTIP election to reduce Gloria's Federal estate tax liability to zero. Is the QTIP election disregarded and does the portability election fail?

**Possible Solutions:**

1. Wait until the IRS clarifies this issue by issuing future guidance and hope that the IRS guidance provides that the QTIP election is valid.
2. Bequeath assets outright to your spouse or to a trust providing your spouse with a general power of appointment.
3. Bequeath all assets to a QTIP trust and only elect QTIP treatment for an amount of assets with total value above \$675,000. This would work because partial QTIPs are unaffected.

If you would like to speak to an attorney about tax or estate planning and/or you have any questions regarding this Memorandum, please do not hesitate to contact Stuart M. Gladstone (973.403.3109 or [sgladstone@bracheichler.com](mailto:sgladstone@bracheichler.com)); David J. Ritter (973.403.3117 or [dritter@bracheichler.com](mailto:dritter@bracheichler.com)); Susan K. Dromsky-Reed (973.403.3146 or [sdromsky-reed@bracheichler.com](mailto:sdromsky-reed@bracheichler.com)) or Jay J. Freireich (973.364.5206 or [jfreireich@bracheichler.com](mailto:jfreireich@bracheichler.com)).

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