

# Drafting the Lifetime

# QTIP Trust

(with Sample Provisions)

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*The lifetime QTIP trust is not just a typical irrevocable trust with some QTIP provisions thrown in.*

ANY COMPETENT ESTATE TAX PLANNER is aware that there are two prerequisites for optimal marital deduction planning. The first prerequisite is properly drafted will or trust documents that divide the assets of the first spouse to die into (1) a marital deduction portion (which can pass to the surviving spouse outright or in a trust qualifying for the marital deduction, such as a QTIP trust), and (2) a nonmarital portion to use the predeceasing spouse's unified credit exemption equivalent of \$650,000 to \$1 million. The nonmarital portion is typically used to fund a by-pass trust (also called a credit shelter trust

or family trust) which benefits the surviving spouse and the children without being subject to estate taxes in the surviving spouse's estate.

The second prerequisite is proper ownership of assets. No matter how beautifully the estate planning documents are drafted, nothing is accomplished if the predeceasing spouse dies with insufficient assets to fund the by-pass trust. Therefore, the couple must be advised that each spouse needs to hold a sufficient amount of assets to allow for proper funding. With most couples, this is not a problem.

However, some couples have one wealthy spouse and one poor (or, at least, not so wealthy) spouse, and the wealthy spouse may object to giving assets to the less-wealthy spouse for estate planning purposes. The less-wealthy spouse may be a spendthrift and the wealthy spouse fears the assets will be squandered or seized by creditors. The less-wealthy spouse may be suffering from a terminal illness (which unfortunately too often is the first time when the question of the proper ownership of assets is meaningfully addressed), and there are fears that if the medical insurance is insufficient, the assets will go to pay medical bills. The wealthy spouse may not want to risk losing the assets in the event of divorce. Also, the natural objects of the wealthy spouse's bounty (such as children from a prior marriage) may differ from the less-wealthy spouse's, and the wealthy spouse does not want to give the less-wealthy spouse any power of testamentary disposition over the assets.

In the above scenarios, clearly an outright gift of assets is not acceptable. Estate planners serving residents of community property states are aided by the fact that one half of all community property will be included in the predeceasing spouse's estate, regardless of how the property is nominally titled. However, if the couple resides in a non-community property state, the estate planner must be more inventive.

#### **ALTERNATIVES TO OUTRIGHT GIFTS •**

One alternative is to purchase term insurance on the less-wealthy spouse's life made payable to the less-wealthy spouse's revocable trust or estate. This is a good choice when the primary concern is a possible future divorce, as the wealthy spouse is not transferring ownership of existing assets. It partially solves the spendthrift

concern, as the less-wealthy spouse will not have spendable assets during his or her lifetime, but his or her creditors will have claims against the estate or revocable trust upon the spouse's death that would be satisfiable from the proceeds. It also does not solve the disposition concern, since the less-wealthy spouse can amend his or her will or trust at any time, and in any event would most likely be the owner of the policy with the power to change beneficiaries. And, of course, the less-wealthy spouse must be insurable at the time the policy is purchased.

#### **Limited Partnership Interests**

Another alternative, if the couple has a family limited partnership, is to give the less-wealthy spouse a sufficient amount of limited partner interests to fund the by-pass trust. This solves the spendthrift concern, since the partnership assets will not be subject to the less-wealthy spouse's creditors, and allows the wealthy spouse, who would presumably either be the general partner or control a corporate general partner, to continue to direct investments and control distributions. However, it does not really solve the divorce concern, nor the concern over testamentary disposition.

#### **Gift Splitting**

A more indirect alternative is for the wealthy spouse to make lifetime gifts of his or her sole property to or for the benefit of the children and other family members, and have the couple elect gift splitting under section 2513 of the Internal Revenue Code ("Code") with respect to such gifts. (All section references are to the Code unless otherwise indicated.) This will use the less-wealthy spouse's gift tax annual exclusions, and to the extent those exclusions are exceeded, his or her unified credit exemption equivalent,

without any transfer of assets to the less-wealthy spouse. However, the couple, realistically or unrealistically concerned that they may need access to the trust assets in the future, may not want to make such a large irrevocable gift to their children during their lifetimes. Also, this method requires a gift of two dollars to use one dollar of the less-wealthy spouse's unified credit exemption equivalent.

**LIFETIME QTIP TRUST** • A final alternative is the inter vivos QTIP trust, or the lifetime QTIP trust. This is an inter vivos irrevocable trust of which the wealthy spouse is the grantor (the "donor spouse") and the less-wealthy spouse is the beneficiary during his or her lifetime (the "donee spouse"). Any contribution to the trust (assuming it is properly drafted and the QTIP election made) by the donor spouse qualifies for the unlimited marital gift tax deduction. During the donee spouse's lifetime, income is distributed to the donee spouse, and principal can be made accessible to the donee spouse as well. The property is included in the donee spouse's taxable estate to use his or her unified credit exemption equivalent, and then passes in some way that will not result in further taxation in the donor spouse's estate, e.g. directly to the children or a trust for their benefit, or to a by-pass trust for the donor spouse for his or her remaining lifetime, with the remainder to the children.

The lifetime QTIP trust makes possible the full use of the less-wealthy spouse's unified credit exemption equivalent. Because the trust will have spendthrift and anti-alienation provisions, its assets are protected from the less-wealthy spouse's creditors both during life and at death. The trust can be structured to restrict the less-wealthy spouse's control over testamentary disposition, and should be unaffected

by divorce (except, of course, for further contributions). Also, if properly drafted, the assets in the trust may potentially receive a full step-up in basis for income tax purposes even if contributed not long before the less-wealthy spouse's death.

**DRAFTING ISSUES** • Drafting the lifetime QTIP trust is, however, more complicated than one would initially think. It is not just a typical irrevocable trust with QTIP provisions. The following major items must be considered.

### **Trusteeship**

To avoid inclusion in the donor spouse's estate, the donor spouse should not serve as trustee. There are no estate or gift tax reasons why the donee spouse cannot serve as trustee, but this would generally be unacceptable to the donor spouse. Therefore, an independent trustee, such as a trustworthy relative or friend, or a corporate trustee, should be appointed. The donor spouse can retain the power to replace any trustee then serving, so long as the replacement trustee is not the donor spouse, or someone who is "related" or "subordinate" to the donor spouse. Rev. Rul. 95-58, 1995-2 C.B. 191.

### **Qualifying Contributions for the Marital Deduction**

Obviously, the lifetime QTIP trust must qualify as a QTIP trust. This means that the donee spouse must have a qualifying income interest for life under section 2523(f) (which incorporates section 2056(b)(7)), which in turn means that the donee spouse must receive all income from the trust during his or her lifetime, payable at least annually, and must at least have the power to require that any property not producing income be made productive. Also, no distri-

butions can be made from the trust during the donee spouse's lifetime except to (or for the benefit of) the donee spouse. The donor spouse must be made to understand and accept that he or she will not have any direct access to the trust assets during the donee spouse's lifetime.

### *Trust Principal*

The QTIP rules do not require that the donee spouse receive distributions of or have any access to trust principal. The trust may provide that the trustee have the power to invade principal for the donee spouse's benefit based on an ascertainable standard (health, education and maintenance), but if the donee spouse is receiving public benefits, this may unnecessarily expose the trust assets to creditor claims. In this case, it would probably be better for distributions of principal to or for the benefit of the donee spouse to be made strictly at the sole and absolute discretion of an independent trustee. This way, the trustee can also terminate the trust if it is no longer necessary or desirable by simply distributing all assets to the donee spouse. The donee spouse may then return the assets to the donor spouse, but the donor spouse must be made to realize that the donee spouse has no obligation to do so. No provision imposing such an obligation may be inserted in the trust document without disqualifying the trust under the QTIP rules.

### *Gift Tax Return*

A timely gift tax return (IRS Form 709) will need to be filed electing QTIP treatment. The gift tax return is due April 15 of the year after the calendar year in which the gift is made. The QTIP election cannot be made on a late return, so if the return is not timely filed (including extensions), the donor spouse will have made a taxable gift.

### **Power of Appointment by Donee Spouse**

Should the donee spouse receive a testamentary power of appointment over the trust assets, and if so, what form should that power take? This is one area where the lifetime QTIP trust differs from the typical QTIP trust that takes effect on death. No power of appointment needs to be given to the donee spouse to qualify the trust as a QTIP trust for marital deduction purposes. However, there is an issue whether the donor spouse's secondary life interest in the trust after the donee spouse's death will result in inclusion of the trust assets in the donor spouse's estate. That question mandates that a power of appointment be carefully considered.

Typically, if a donor contributes property to a trust and retains, for his life or for a period not ascertainable without reference to his death, any right to the property or the income therefrom, or the right to designate persons who would possess the property or receive income therefrom, the property is includable in the donor's estate under section 2036(a). Also, the retained interest may allow the creditors of the donor to access the trust property under state law, causing estate tax inclusion. *Paolozzi v. Commissioner*, 23 T.C. 182 (1954), *acq.* 1962-1 C.B. 4; Rev. Rul. 76-103 1976-1 C.B. 293. This would appear to mean that any interest by the donor spouse in a lifetime QTIP trust after the donee spouse's death would cause inclusion in the donor spouse's estate, partially defeating the purpose of the trust.

To change this result, Congress enacted section 2523(f)(5) regarding treatment of interests retained by the donor spouse. Section 2523(f)(5)(A) provides that the gift of QTIP property will not be included in the estate of the donor spouse. However, subparagraph (B) provides that subparagraph (A) does not apply if the

property is includable in the donee spouse's estate under section 2044. Section 2044 is the provision that includes QTIP property in the recipient spouse's estate. Read literally, this means that a retained interest by the donor spouse will not cause inclusion in the donor spouse's estate, but only if the donor spouse predeceases the donee spouse.

Treas. Reg. §25.2523(f)-1(d) appears to ignore subparagraph (B), however, and reads as follows:

"(1) IN GENERAL. Under section 2523(f)(5)(A), if a donor spouse retains an interest in qualified terminable interest property, any subsequent transfer by the donor spouse of the retained interest in the property is not treated as a transfer for gift tax purposes. *Further, the retention of the interest until the donor spouse's death does not cause the property subject to the retained interest to be includible in the gross estate of the donor spouse.* (Emphasis added.)"

The Regulations would seem to estop the IRS from claiming the literal interpretation of section 2523(f)(5), but some cautious commentators, worried that the IRS may change the Regulations, have suggested giving the donee spouse a testamentary general power of appointment to try to make subparagraph (B) inapplicable, because the property would then be includable in the donee spouse's estate under section 2041, not just section 2044.

Another potential advantage of giving the donee spouse a testamentary general power of appointment, if the power is exercisable in favor of the donee spouse or the donee spouse's estate and is exercisable by the donee spouse alone and in all events, is that if for some reason there is a failure to file a gift tax return timely electing

QTIP treatment, the contributions to the trust would still qualify for the marital deduction as a gift to a power of appointment trust under section 2523(e). However, if this were to occur, the protection of section 2523(f)(5) and the Regulations, which by their terms apply only to qualified terminable interest property, would be unavailable, and the donor spouse would need to renounce any secondary life interest in the property to avoid inclusion under section 2036(a), with the three-year rule under section 2035 being applicable.

### *Generation Skipping*

A disadvantage of using a general power of appointment is that it would prevent the trust from being used for generation-skipping planning purposes using the donor spouse's GST exemption. This is because the reverse QTIP election under section 2652, under which the donor spouse could elect that he or she be treated as the transferor of the trust assets for purposes of the GST tax notwithstanding the inclusion of the assets in the donee spouse's estate under section 2044, would no longer be available. However, this is probably not a major concern, as the donee spouse's GST exemption can be allocated to the trust assets, albeit valued as of the date of the donee spouse's death, and the donor spouse probably has sufficient other assets against which the donor spouse's exemption can be allocated.

### *Structuring the Donee's Power of Appointment*

Several private letter rulings blessing lifetime QTIP trusts under which the donor spouse reserved a secondary life estate provide ideas about how to structure the donee spouse's power of appointment.

In Pvt. Letter Ruls. 9026036 and 9437032, the donee spouse had only a limited testamentary power of appointment. Because a limited power of appointment does not cause estate tax inclusion under section 2041, this suggests that the IRS is following its Regulations, even if the only basis for inclusion in the donee spouse's estate is section 2044. Giving the donee spouse a limited power to appoint trust assets among the donor spouse's children, or simply to the donor spouse's children in equal shares, would appear to be a safe and acceptable provision that could be used to divest the donor spouse of any taxable secondary life interest if the IRS unfavorably changes its position.

In Pvt. Letter Rul. 9109029, the donee spouse's general testamentary power of appointment was exercisable only with the consent of a nonadverse party. These powers were drafted to cover inclusion in the donee spouse's estate under section 2041, and to remove the trust assets from the reach of the donor spouse's creditors under state law. They also appear to have been drafted to preclude automatic qualification for the marital deduction as a power of appointment trust under sections 2056(b)(5) or 2523(e), perhaps to insure qualification as QTIP property for the purpose of section 2523(f)(5). However, the IRS has ruled that the presence of a general power of appointment, even one that qualifies the trust as a power of appointment trust, does not preclude a QTIP election, even though the election is unnecessary for marital deduction purposes. See T.A.M. 8943005 (ruling estate's QTIP election as valid notwithstanding surviving spouse's inter vivos general power of appointment in favor of herself, qualifying trust as power of appointment trust under section 2056(b)(5)).

Based on the above, the cautious drafter may want to consider giving the donee spouse a testamentary general power of appointment, exercisable in favor of his or her estate. Making the power exercisable only with the consent of a nonadverse party in the form of an independent trustee whom the donor spouse appointed and over whom the donor spouse holds a replacement power would prevent the donee spouse's exercise of the power without the donor spouse's consent.

**DRAFTING THE BY-PASS TRUST** • Think carefully about the by-pass trust for the benefit of the donor spouse and perhaps the children after the death of the donee spouse.

#### **Avoiding Section 2036(a)**

Because of the uncertainty involving section 2523(f)(5), the donor spouse should not be the trustee, not even after the death of the donee spouse.

#### **Income Tax Planning**

If the by-pass trust is properly structured, the lifetime QTIP trust may possibly allow a full step-up in basis on the death of the donee spouse, notwithstanding section 1014(e), which denies a step-up if the decedent acquires the property within one year before death, and the property passes at the decedent's death back to the original donor (or the original donor's spouse). The question is whether and to what extent this section applies if the property passes instead to a trust for the benefit of the donor.

There are no regulations regarding section 1014(e), but the IRS ruled in Pvt. Letter Rul. 9026036 that where, upon the donee spouse's death, the property passed to a trust that gave a life income interest to the donor spouse, only

the actuarial portion of the trust assets allocable to the life income interest would be subject to section 1014(e), and the remainder would receive a full step-up in basis. This private letter ruling was partially reversed in Pvt. Letter Rul. 9321050, but on an unrelated issue.

Based on this ruling, T. Randolph Harris has suggested (*see* Appendix 1: Bibliography) that a full step-up in basis may be available when the donor spouse has no interest in the trust capable of actuarial valuation. He therefore recommends that the trust be structured so that an independent trustee has sole discretion over distributions to the donor spouse, rather than drafting for an income interest or distributions of income or principal based on an ascertainable standard, either of which is susceptible to actuarial valuation.

#### **Avoiding Possible "Overstuffing"**

A danger in using the lifetime QTIP trust is that estate taxes may be incurred if the trust is "overstuffed," that is, if the value of the assets in the trust on the donee spouse's death exceeds his or her remaining unified credit exemption equivalent. In the typical will or revocable trust, this is handled through the marital deduction formula clause, which ensures that only the maximum amount that will not incur an estate tax passes to the by-pass trust. Mary Ann Mancini and Laura L. Quam in their article (*see* Appendix 1: Bibliography) believe that a similar formula provision in a lifetime QTIP trust that returns the excess of value of the trust assets to the donor spouse may cause an incomplete gift or inclusion of all of the trust assets in the donor spouse's estate, notwithstanding section 2523(f)(5) and its Regulations.

Other than deliberately underfunding the trust, which allows for possible waste of the donee spouse's unified credit exemption equivalent and decreases the trust's utility, the only alternative appears to be to structure the by-pass trust so that a portion could qualify as a QTIP trust if the QTIP election is made on the donee spouse's estate tax return. This way, a partial QTIP election could be made with respect to the portion of the trust assets exceeding the donee spouse's unified credit exemption equivalent. Because giving an automatic income interest to the donor spouse would actuarially reduce the potential step-up in basis, an income interest contingent on the QTIP election, which was recently blessed by the IRS in final Treas. Reg. §20.2056(b)-7(d)(3), would appear to be preferable here. That way, only the actuarial value of the income interest on the portion over which the QTIP election is made (if any) should be subject to section 1014(e).

#### **Power of Appointment**

Obviously, the donor spouse cannot be given a general power of appointment over the assets in the by-pass trust, as this would cause estate tax inclusion. The less clear question is whether the donor spouse may have a limited power of appointment over the assets. In Pvt. Letter Ruls. 8944009 and 9437032, the IRS ruled that the inter vivos QTIP trusts at issue would not be included in the donor spouse's estate, notwithstanding the limited power of appointment that the donor spouse retained in the by-pass trust.

This limited power of appointment must only take effect, if at all, if the donee spouse predeceases the donor spouse. The underlying theory behind the taxpayer-favorable rulings that

the IRS has issued in this area is that the inclusion of the assets in the donee spouse's estate somehow "cleanses" the donor spouse of his or her status as grantor, and the donee spouse is effectively treated as the grantor of the trust.

#### **MAKE THE TRUST A GRANTOR TRUST •**

An estate- and gift tax- neutral grantor trust power should be added so that the trust's income is taxable to the donor spouse. This can be accomplished by, for example, giving the donor the power to substitute trust assets with other assets of equal value in a nonfiduciary capacity, which makes the trust a "grantor" trust under section 675(4). This will avoid application of the compressed trust income tax rates on trust income. It will also permit contributions of S corporation stock without terminating the corporation's S election. In addition, if an interest in the couple's residence or a vacation home is contributed to the trust, grantor trust status should preserve availability of the home mortgage interest deduction and the \$250,000/\$500,000 capital gains exclusion under new section 121. Rev. Rul. 85-45, 1985-1 C.B. 183; Pvt. Letter Ruls. 9309023, 9118017 and 8549046. While these rulings addressed the one-time \$125,000 exclusion

under old section 121, the ownership and use rules between new section 121 and old section 121 are sufficiently similar that the IRS will probably rule the same way on new section 121.

#### **WAIVE ESTATE TAX APPORTIONMENT**

• Section 2207 gives a decedent's estate a right of reimbursement for estate taxes payable on assets included in the decedent's estate because the decedent held a general power of appointment. Section 2207A gives a decedent's estate a right of reimbursement for estate taxes payable because QTIP property was included in the decedent's estate under section 2044. Both sections permit the decedent to waive such right of reimbursement in his or her will. Because any estate taxes paid from the Lifetime QTIP Trust would reduce the amount passing to the bypass trust for the donor spouse, the donee spouse's will should contain an explicit waiver of these provisions.

**CONCLUSION •** Properly drafted, the inter vivos or lifetime QTIP trust can provide valuable estate tax and income tax benefits to certain clients.

### **APPENDIX 1**

#### **Author's Bibliography**

T. Randolph Harris, Esq., *Even the Blackest Cloud Has a Silver Lining: Wealth Transfer Planning for the Terminally Ill Client*, 32nd Annual Phillip E. Heckerling Institute on Estate Planning, University of Miami School of Law, 1998.

Mary Ann Mancini and Laura L. Quam, *Making Full Use of the \$600,000 Estate Tax Exemption With the Inter Vivos QTIP Trust*, *Journal of Asset Protection*, July/August 1996.

Jeffrey Pennell, 843 T.M., *Estate Tax Marital Deduction*

Howard M. Zaritsky, *Tax Planning for Family Wealth Transfers: Analysis With Forms*. (3rd Edition, Warren Gorham Lamont, 1997).



## APPENDIX 2

## Sample Provisions for Inter Vivos QTIP Trust

\_\_\_\_. **Administration During Spouse's Lifetime.** During my spouse's lifetime, the Trustee shall hold, manage, and distribute the assets comprising the trust estate as follows:

1. *Income.* The Trustee shall pay to or for the benefit of my spouse during such spouse's lifetime all the net income of the Trust in convenient installments but no less frequently than annually.
2. *Underproductive Property.* My spouse may at any time, by written notice, require the Trustee either to make any nonproductive property productive or to convert such nonproductive property to productive property within a reasonable time.
3. *Principal.* The Trustee may, but need not, pay to or for the benefit of my spouse such amounts of principal of this Trust, up to the whole thereof, as the Trustee, in its absolute and sole discretion, may from time to time deem necessary or advisable.
4. *Prohibited Distributions.* Notwithstanding anything in this Trust Agreement to the contrary, no distribution of income or principal shall be made from this Trust to or for the benefit of anyone but my spouse during my spouse's lifetime.
5. *Power of Appointment.* My spouse shall have a testamentary power of appointment with respect to the Trust property, and upon my spouse's death, the Trustee shall pay the remaining principal, or such portion thereof over which said power is exercised, as my spouse directs pursuant to the exercise of such power. The power of appointment described herein shall be exercisable only with the written consent of the Trustee then serving and shall be exercisable either (i) in favor of my spouse's estate, or (ii) in favor of my then-surviving children in equal shares, per stirpes, subject to the Children's Trust provisions of Article \_\_\_\_ of this Trust Agreement.

\_\_\_\_. **Administration After Death of My Spouse.** Upon my spouse's death, if I am then surviving, the Trustee shall hold, manage, and distribute any remaining assets not otherwise appointed as follows:

1. *Income.* The Trustee shall pay to me or for my benefit during my lifetime all the net income of the Trust in convenient installments but no less frequently than annually, provided, however, that this provision shall not apply to any portion of this Trust that the personal representative of my spouse's estate fails to elect to treat as qualified terminable interest property under section 2056(b)(7) of the Code.
2. *Underproductive Property.* I may at any time, by written notice, require the Trustee either to make any nonproductive property productive or to convert such nonproductive property to productive property within a reasonable time.
3. *Principal.* The Trustee may, but need not, pay to me or for my benefit such amounts of principal of this Trust, up to the whole thereof, as the Trustee, in its absolute and sole discretion, may from time to time deem necessary or advisable.
4. *Prohibited Distributions.* Notwithstanding anything in this Trust Agreement to the contrary, no dis-

tribution of income or principal shall be made from this Trust to or for the benefit of anyone but me during my lifetime, provided that this restriction shall not apply to any portion of this Trust that the personal representative of my spouse's estate fails to elect to treat as qualified terminable interest property under section 2056(b)(7) of the Code, and the Trustee shall be able to make distributions from any such portion to or for the benefit of any child of mine, in addition to myself, as the Trustee deems appropriate in its sole and absolute discretion.

5. *Limited Power of Appointment.* I shall have a testamentary power of appointment with respect to the Trust property, exercisable only after the death of my spouse if such spouse predeceases me, and upon my death, the Trustee shall pay the remaining principal, or such portion thereof over which said power is exercised, as I may direct pursuant to the exercise of such power, provided that I shall be prohibited from exercising this power in favor of myself, my estate, my creditors, or the creditors of my estate.

\_\_\_\_. **Administration After Death of Survivor of Myself and My Spouse.** Upon the death of the survivor of myself and my spouse, the Trustee shall divide the remaining trust property into equal separate shares for the benefit of my children then surviving, per stirpes, and each separate share shall be held, managed, and distributed for the benefit of such child pursuant to the Children's Trust provisions of Article \_\_\_\_ of this Trust Agreement.

\_\_\_\_. **Trustee Replacement Power.** I may remove any Trustee of a Trust under this instrument who is then serving or who is designated as a successor or alternate Trustee and may also name any "Eligible Person," as defined herein, to serve as Trustee in the place of the removed Trustee.

1. An "Eligible Person" is a licensed trust company or an individual (other than myself) who is neither related nor subordinate to me. For this purpose, "related" and "subordinate" have the same meaning that they have under section 672(c) of the Internal Revenue Code of 1986, as amended.

2. The right to remove and replace a Trustee under this section may be exercised by a writing delivered to the then-serving Trustee, signed by me, and indicating the effective date of the removal, the identity of the replacement Trustee, and the agreement of the replacement Trustee to serve. No cause or justification shall be required for any removal or appointment under this section.

\_\_\_\_. **Grantor Trust Power.** I may, without the approval or consent of any person in a fiduciary capacity, at any time and from time to time, reacquire any part or all of the Trust property by substituting other property of equal value, and such power may be exercised in a non-fiduciary capacity without approval or consent of any third party except as to the value of property exchanged.

### PRACTICE CHECKLIST FOR Drafting the Lifetime QTIP Trust (with Sample Provisions)

The lifetime QTIP trust is an irrevocable trust where any contribution to the trust (assuming it is properly drafted and the QTIP election made) by the donor spouse qualifies for the unlimited marital gift tax deduction. During the donee spouse's lifetime, income is distributed to the donee spouse, and principal can be made accessible to the donee spouse as well. The property is included in the donee

spouse's taxable estate to use his or her unified credit exemption equivalent, and then passes in some way that will not result in further taxation in the donor spouse's estate, e.g. directly to the children or a trust for their benefit, or to a by-pass trust for the donor spouse for his or her remaining lifetime, with the remainder to the children.

- Drafting the lifetime QTIP trust is, however, more complicated than one would initially think. It is not just a typical irrevocable trust with QTIP provisions. The following major items must be considered.

- Trusteeship. Don't have the donor serve as trustee;
- Qualifying contributions from the marital deduction. Consider asset protection provisions if the donee spouse has creditor problems or special needs trust provisions if the donee spouse may be eligible for public benefits;
- Power of Appointment by donee spouse. Conservative planners may wish to consider a specially structured general power of appointment.
- In drafting the by-pass trust for the donor spouse after the donee spouse's death:
  - Do not make the donor the trustee;
  - Use an independent trustee with power to make distributions based on a sole discretion standard to permit possible step-up in basis; and
  - Draft to permit a possible partial QTIP election to avoid "overstuffing" the trust so that its value at the donee's death does not exceed the donee's remaining unified credit exemption equivalent.
- Some other considerations in drafting the inter vivos QTIP trust:
  - Make the trust a grantor trust;
  - Consider a trustee replacement power; and
  - Waive estate tax apportionment under sections 2207 and 2207A.