James M. Kane on the Inter-Vivos QTIP Marital Trust: Now Even Better in Georgia

"For couples who do not have the need or financial wherewithal for an offshore (e.g., Cook Islands) asset-protection trust or an out-of-state DAPT asset-protection trust, an inter-vivos QTIP trust in the couple's own state is an excellent tax planning and asset-protection option, especially if their state provides statutory asset-protection for the settlor spouse's secondary trust interest in the inter-vivos QTIP trust. Effective July 1, 2018, Georgia enacted an asset-protection feature specifically and favorably for inter-vivos QTIP marital trust planning. The benefit is that the settlor spouse Jane -- at the time Jane creates her inter-vivos QTIP trust -- now can include trust provisions that allow Jane later to become a beneficiary in the event Jane's spouse dies first. The key aspect of this statutory asset protection feature is that Jane -- by writing herself in as a secondary beneficiary of her own QTIP trust -- is not considered to have self-settled (or self-funded) the trust when Jane later becomes (but only if Jane survives her spouse John) a beneficiary under her own trust document."

James M. Kane provides members with commentary that focuses on a married couple's use of an *inter-vivos* QTIP marital trust, especially in states like Georgia that now provide statutory asset-protection for the settlor spouse's secondary trust interest in the QTIP trust.

Attorney James M. Kane, with the Atlanta law firm **KaneTreadwell Law** LLC [www.ktlawllc.com), is primarily a tax and trust controversies/litigation lawyer. Prior to law school James was a Revenue Agent with the IRS's large-case examination division in Atlanta, This combined tax, trust, and litigation experience gives James a broad perspective for identifying, understanding, and addressing complex trust issues and disputes along with the resulting tax and non-tax factors that ideally must together be taken into account. James also assists other lawyers as both a consulting and expert witness in both tax and non-tax litigation matters where trusts are at the center of the dispute, and handles trust, estate, asset protection, and prenuptial (postnuptial) planning, with his planning work influenced heavily by the various hurdles James sees in the controversy / litigation arena. James is licensed in Georgia, North Carolina, and New York. He has 20+ years' experience previously with Atlanta law firms Sutherland, Asbill & Brennan and Chamberlain, Hrdlicka, White, Williams & Aughtry.

James attended Emory University Law School and has undergraduate finance (University of Georgia) and graduate business (Georgia State University) degrees. Although he never worked as a CPA, James held a CPA certificate during his time with the IRS. James was the winner of the 2016 Heckerling Tax Court Brief writing contest. James' outside interests include studying jazz guitar. Google also: James Kane Legal Blog

Here is his commentary:

EXECUTIVE SUMMARY:

For couples who do not have the need or financial wherewithal for an offshore (e.g., Cook Islands) asset-protection trust or an out-of-state DAPT asset-protection trust, an *inter-vivos* QTIP trust in the couple's own state is an excellent tax planning and asset-protection option, especially if their state provides statutory asset-protection for the settlor spouse's secondary trust interest in the *inter-vivos* QTIP trust. Effective July 1, 2018, Georgia enacted an asset-protection feature specifically and favorably for *inter-vivos* QTIP marital trust planning.[i] The benefit is that the settlor spouse Jane -- at the time Jane creates her *inter-vivos* QTIP trust -- now can include trust provisions that allow Jane later to become a beneficiary in the event Jane's spouse dies first. The key aspect of this statutory asset protection feature is that Jane -- by writing herself in as a secondary beneficiary of her own QTIP trust -- **is not considered to have self-settled (or self-funded) the trust** when Jane later becomes (but only if Jane survives her spouse John)) a beneficiary under her own trust document.

COMMENT:

Preface – The Notion of Asset Protection Planning

I preface this commentary with the following important, brief notion about asset protection planning. Many clients too narrowly believe that asset protection planning is only for the super-wealthy, or for illicit money someone is attempting to hide, or rich guys who stash away assets from their wives, etc. Some clients also believe is it simply wrong not to pay one's debts or not satisfy claims that might arise. This, no doubt, is an admirable, aspirational hope.

But my general reply is that I, personally as an illustration, have the utmost and first responsibility to protect my spouse and kids from an asset protection perspective. And, if a situation were ever to occur where the claims of a creditor – even if entirely *bona fide* – could or would result in my family becoming financially destitute, then my obligation (ethically and otherwise) in my opinion is first to protect my family, even where this protection leaves an otherwise *bona-fide* creditor empty-handed. This is a perspective I often invite clients to contemplate for their own families.

The Protective Benefits of an *Inter-vivos* QTIP Trust

I have written frequently over the years about one of my favorite estate planning / tax / asset-protection trusts, called the *inter-vivos* QTIP marital trust. *See, generally,* Internal Revenue Code Section 2523(f). "*Inter-vivos*" is the oft-used lawyer term for a trust that someone creates while alive; compared to a "testamentary" trust that comes into existence when a person dies (such as a trust spelled out in that person's Last Will and Testament).

Setting aside a discussion of the minutiae of the technical trust and tax law design features of an *inter-vivos* QTIP trust, my optimal framework generally is as follows:

> (1) Married spouse Jane creates and funds the *inter-vivos* QTIP trust with her assets;
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> (2) The beneficiaries of the QTIP trust include Jane's spouse John, and ultimately Jane's children, grandchildren, etc.
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> (3) Under the tax rules for a QTIP trust, John, the spousal QTIP trust beneficiary, can be the only person who receives income or principal distributions from the trust during John's remaining lifetime. **But, the next point** in the design is a **key distinction** for this only-to-John distribution mandate;
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> (4) Jane, who creates and funds this *inter-vivos* QTIP trust, **retains a limited power of appointment** under the express written terms of this QTIP trust document. Jane can, therefore, at any time exercise

her power to redirect trust income or principal to any of the persons who are the defined "appointees" of her power of appointment. The written trust provisions can include John and Jane's children, grandchildren, etc., in this defined group. Therefore, although John is **ostensibly** the only beneficiary to whom the QTIP trust income and principal can be distributed during his lifetime, Jane, nonetheless, can trump this all-to-John requirement if, and whenever, Jane exercises her limited power of appointment. Under the tax law, however, Jane cannot exercise this power to get any trust income or principal back to herself;

(5) This next point is very important. Jane's above limited power of appointment makes this QTIP trust an **incomplete gift for gift tax purposes**. Thus, if thereafter Jane is the first-to-die, the value of the QTIP assets at Jane's death will be included in her estate for estate tax purposes, qualify for an estate QTIP marital deduction, and get a death stepped-up cost basis, beneficial for reducing income tax on any otherwise taxable gains on the trust property. Jane while alive, alternatively, can instead purposely trigger marital deduction gift treatment during her lifetime if she gives up (releases) her limited power of appointment;

(6) Under the income tax rules, and because Jane creates the *inter-vivos* QTIP trust while she is alive, the QTIP trust is defective for income tax purposes as to both Jane and John, with that defective income tax status continuing for the surviving spouse's remaining lifetime **regardless** of whether Jane or John is the surviving spouse. *See* IRC Sections 676, 677. With this defective income tax status, **no separate Form 1041 trust income tax return is required** for the QTIP trust; instead, all income, gains deductions, etc., each year are reported on Jane and John's individual Form 1040 personal income tax returns;

(7) This next beneficial feature now is available under Georgia law. That is, if John dies first, the terms of the QTIP trust document -- but only after John's death – at that time will trigger inclusion of **Jane as a beneficiary** of the QTIP trust. Jane can then receive trust income and principal until her death, **from this same QTIP trust Jane originally funded**. Jane's children (grandchildren, etc.) thereafter are the trust beneficiaries when both John and Jane are no longer living;

(8) This point is my most complex discussion in this blog post. Extremely important as to the preceding point, and effective July 1, 2018, Georgia enacted its asset-protection feature specifically – and favorably — for *inter-vivos* QTIP planning. The benefit is that Jane — at the time Jane creates this *inter-vivos* QTIP trust -- now can include the provisions that allow her later to become a beneficiary in the event John dies first. The key aspect of this Georgia change in its law is that Jane -- by writing herself in as a beneficiary of her own trust -- **is not considered to have self-settled (or self-funded) the trust** at the time (and if) Jane later becomes a beneficiary under her own trust document.

Under this favorable Georgia law, John is **deemed** for asset protection purposes -- if John dies first -- to have himself funded the QTIP trust for the benefit thereafter of Jane. The QTIP trust is not, therefore, "self-settled" as to Jane if she becomes a beneficiary of the trust. By contrast, without this favorable Georgia law, Jane becoming a beneficiary of her own trust would open the door for her third-party creditors to make a grab at otherwise "self-settled" trust property to satisfy claims and judgments against Jane. This July 2018 change in the Georgia law blocks this creditor grab and is in O.C.G.A. Section 53-12-82. This Georgia statutory benefit applies **only to** *inter-vivos* QTIP marital trusts under IRC Section 2523(e)[*inter-vivos* life estate with power of appointment marital trusts] and Section 2523(f)[*inter-vivos* QTIP marital trusts]; but **not** to other types of *inter-vivos* trusts;

(9) Other materially key features of this *inter-vivos* QTIP design are: **(i) Asset protection each for Jane and John**: In addition to the above secondary interest protection for Jane if she survives John, while Jane and John are both living the QTIP trust funding by Jane is irrevocable and she no longer owns the property from which her creditors can seek to levy or grab. On the flip side, John did not fund the trust with his assets. Therefore, the trust is not self-settled as to John, which provides a steep hurdle for creditors seeking to grab the trust property for claims against John; **(ii) Medicaid nursing home planning for Jane**: The five-year Medicaid look-back clock starts for Jane at the time she funds the trust. This, at least, provides potential Medicaid nursing home planning for one of the two spouses Jane; and **(iii) Divorce?** What if Jane and John later decide to divorce?

Jane at that time, as part of the resolution of the divorce, can — merely as one example — exercise her limited power of appointment to distribute the trust property to John, with that property then divided between them as part of their divorce judgment, or consistent with their prenuptial or post-nuptial agreement, etc.

Conclusion

I recommend you give thought fundamentally to the above *inter-vivos* QTIP trust as an asset protection option for your family, but also considering the QTIP trust's other tax and non-tax features. Contact me at james@ktlawllc.com if you wish to discuss this *inter-vivos* QTIP planning further. There is an abundance of information on the web about use of an *inter-vivos* QTIP trust. An excellent resource also is Internal Revenue Service Private Letter Ruling 200413011 that includes a thorough, in-depth discussion of many of the components for the *inter-vivos* QTIP design I recommend and use. I will be glad to email a copy of this IRS letter ruling to you at your request.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

James M. Kane

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professional should be sought. Statements of fact or opinion are the responsibility of the authors and do not represent an opinion on the part of the officers or staff of LISI.

CITATIONS:

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[i] **Steve Akers** at **Bessemer Trust** recently was very kind (and as always expertly thorough) to provide me with his summary of states that at present have protective statutes for *inter vivos* QTIP trusts, similar to the Georgia statute I discuss in this newsletter. Steve Akers' listing of these 18 states is: Arizona, Arkansas, Delaware, Florida, Georgia, Kentucky, Maryland, Michigan, New Hampshire, North Carolina, Ohio, Oregon, South Carolina, Tennessee, Texas, Virginia, Wisconsin, and Wyoming. I understand Steve is also discussing this issue in his summary that will be published in the near future of the seminars at the ACTEC 2020 Annual Meeting.