

HAVING YOUR CAKE AND EATING IT TOO

**Use of Inter Vivos QTIP Trusts and SLATs to Enhance
Estate and Asset Protection Planning**

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Questions to Help You Determine If You Should Make Gifts Now

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*These questions are taken from the “6 Question 2018 Gift Suitability Analysis”
included as Exhibit 1 of Barry A. Nelson’s Workshop Materials*

The following list of questions is provided to facilitate your consideration of whether to make gifts in 2018 (or before January 1, 2026) using the current basic exclusion amount. All decisions require careful consideration of the current income tax basis of assets to be gifted, projected future appreciation, whether the gifts will be made to a grantor trust that includes a Substitution Power to potentially mitigate the loss of income tax basis, and the extent of potential exposure to creditors’ claims (see the Additional Factors, above).

- 1) To save future Transfer Taxes, would you be willing to make 2018 gifts of up to \$5.59 Million (single), \$11.18 Million (jointly with spouse), plus any amount of unused exemption that was available in 2017, \$5.49 Million (single), \$10.98 Million (jointly with spouse), if such gifts can be made free of gift taxes, provided that neither you nor your spouse would have access to such funds, regardless of any reversal in your financial position? Note: If prior taxable gifts were not made, each person can make gifts in 2018 of \$11.18 Million (single) or \$22.36 Million (jointly with spouse).

If no, read on. If yes, you are a good candidate for gifting to a trust for your children and grandchildren subject to the Additional Factors.

- 2) To save future Transfer Taxes, would you make 2018 gifts of up to \$5.59 Million, plus any amount of unused Transfer Tax exemption that was available in 2017, \$5.49 Million (single), \$10.98 Million (jointly with spouse), into a trust for your spouse (and possibly your children) where your spouse and children may receive distributions at the discretion of the trustee (you may not be a beneficiary or a trustee). Upon the death of your spouse, the trust assets will be held exclusively for your children (they will not pass back to you even if you survive your spouse).

If no, read on. If yes, you are a good candidate for gifting to a Spousal Limited Access Trust (“SLAT”) without a back end retained interest subject to the Additional Factors.

- 3) To save future Transfer Taxes, would you make 2018 gifts of up to \$5.59 Million, plus any amount of unused Transfer Tax exemption that was available in 2017, \$5.49 Million (single), \$10.98 Million (jointly with spouse), into a trust for your spouse (and possibly your children) in 2018 where your spouse and children may receive distributions at the discretion of the trustee (you are not a beneficiary or trustee). Upon your spouse’s death, your spouse can decide on whether all or any portion of the assets in the trust revert into a new trust created by your spouse for your benefit and in such event, an independent trustee will determine the extent of distributions to you. Note: Based upon the Relation Back Doctrine (discussed below) it is possible your spouse’s decision to distribute all or any portion of the assets back to you into a new trust for your benefit may be considered to be assets held in a self-settled trust created by you for your own benefit rather than a third party created trust created by your spouse. There is a possibility that such a trust, if created in a state that has not adopted domestic self-settled asset protection legislation, will be subject to your creditors’ claims and accordingly, such assets may be includible in your estate.

If no, read on. If yes, you are a good candidate for a SLAT that includes a testamentary power of appointment that may be exercised by your spouse subject to the Additional Factors and the Relation Back Doctrine issues, described below.

- 4) To save future Transfer Taxes, would you make 2018 gifts of up to \$5.59 Million, plus any amount of unused Transfer Tax exemption that was available in 2017, \$5.49 Million (single), \$10.98 Million (jointly with spouse), into a trust designating your spouse and children as discretionary beneficiaries but providing that on a predetermined future date, the assets are distributed outright or in trust for your children if your net worth is at least a specified value determined upon creation of the trust that you believe would result in you having sufficient assets outside the trust to provide for you and your spouse for the rest of your life?

If no, read on. If yes, you are a good candidate for a SLAT with a predetermined termination formula in favor of your children subject to the Additional Factors.

- 5) To save future Transfer Taxes, would you make a 2018 gift into a trust in one of a number of states that have enacted self-settled asset protection trust legislation (e.g., Alaska, Delaware, South Dakota, or Nevada) or to a foreign asset protection trust jurisdiction where you, your spouse, and possibly your children are potential beneficiaries with the understanding that the IRS may argue that, as a potential trust beneficiary, all trust assets will be included in your estate upon your death (especially if the trustee has exercised its power to make regular distributions to you during your lifetime)? See PLR 200944002, attached, for an IRS ruling in favor of an Alaska resident who created an Alaska self-settled trust (the “Alaska PLR”). Note: The Alaska PLR included important caveats (quoted on page 5 of this letter, below). If you prefer to have greater certainty as to Transfer Tax planning, consider making gifts as described in questions 1-4, above. If you prefer to have greater asset protection certainty, consider making gifts as described in question 6, below.

If yes, you may be a good candidate for a domestic or foreign irrevocable self-settled asset protection trust plan.

- 6) If (i) estate tax savings are not a concern because of the combined \$22.36 Million basic exclusion amount for you and your spouse, (ii) you are comfortable that your net worth, when aggregated with your spouse’s net worth, will not exceed the basic exclusion amount that may be available in the future understanding that the \$11.18 basic exclusion amount could be reduced, and (iii) you want to significantly enhance asset protection planning, would you transfer significant sums to an inter vivos QTIP trust for your spouse, retaining the right to such trust assets if your spouse predeceases you? If so, would your spouse consider a similar, but not identical, gift into a trust for you?

If no, making gifts of your increased 2018 basic exclusion amount is probably not for you. If yes, you are a candidate for an inter vivos QTIP trust, especially if you are domiciled in Florida or one of the other 16 states that have enacted inter vivos QTIP legislation, which protects trust assets that revert to a trust for the original settlor upon the death of the original donee spouse (i.e., the “Inter Vivos QTIP Trust Jurisdictions”). These states effectively override the Relation Back Doctrine concerns as any “deemed” self-settled trust is disregarded under the Inter Vivos QTIP Jurisdictions statutes because they consider the original donee spouse as the settlor of the trust that is held for the original settlor spouse should the original donee spouse die first. However, be aware of the potential income tax consequences that may arise in the event of divorce and recent repeal of Code Section 682. As a result of these potential consequences a post-nuptial agreement should be a part of any such plan.

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Use of Inter Vivos QTIP Trusts and SLATs to Enhance Estate and Asset Protection Planning

1-1 INTRODUCTION

As a result of the 2017 Tax Act increasing the Basic Exclusion Amount to \$11.4 Million (single) and \$22.8 Million (married) inflation-adjusted for the year 2019 based upon Rev. Proc 2018-57, those who are married should consider whether to initiate inter vivos QTIP trust or SLAT (Spousal Limited Access Trust) planning to enhance asset protection and possibly reduce estate, gift, and GST taxes. This Chapter discusses the benefits and drawbacks of inter vivos QTIP trusts and SLATs and the issues that must be considered before a decision is made as to which option may be best.

Inter vivos QTIP trusts provide the greatest certainty as to asset protection and step up in income tax basis benefits for states, like Florida, that have inter vivos QTIP trust statutes, which make it clear that if inter vivos QTIP trust assets revert to the initial donor spouse in trust, the trust for the initial donor spouse is considered to be created by the initial donee spouse of the inter vivos QTIP trust and accordingly is protected from creditors of the initial donor spouse. However, inter vivos QTIP trusts do not freeze asset values for estate tax purposes or insure the use of the existing Basic Exclusion Amount should a future Congress reduce the Basic Exclusion Amount from its current level of \$11.4 Million. In contrast, SLATs create an estate tax freeze as to post-gift appreciation and lock in the use of the existing Basic Exclusion Amount but have less statutory asset protection. SLATs have uncertain tax benefits if the SLAT donor becomes a beneficiary of the SLAT upon the death of the initial donee spouse. When deciding whether to create an inter vivos QTIP trust or a SLAT under existing law the following ten (10) factors should be considered (referred to herein as the "Additional Factors"):

1. Net Worth: Projected value of spouses combined assets compared to the existing Basic Exclusion Amount of \$11.4 million (single) and \$22.8 million (married) (i.e., whether it is likely that the aggregate net worth of both spouses is likely to be sheltered by the combined Basic Exclusion Amounts of both spouses taking into account portability and annual increases);¹
2. Basic Exclusion Amount: The likelihood that the Basic Exclusion Amount will be reduced by future legislation;
3. Ultimate Estate Beneficiaries: The benefit of making spousal gifts in trust rather than outright where there are children from separate marriages or possible disparity in desired ultimate beneficiaries (e.g., where: (i) one spouse prefers charitable gifts and the other spouse prefers gifts to individuals; or (ii) there are blended families and one spouse wants to provide only for their children upon the death of the surviving spouse rather than the children of the surviving spouse);
4. Potential for Creditor Claims: The likelihood of creditor claims against either spouse while married or upon the death of the first spouse;
5. Income Tax Basis Issues: Whether spouses own low basis assets or assets that have liabilities that exceed income tax basis and how likely it is that such assets will be sold or reacquired by the donor spouse (through a substitution power) before or after death of the donor;

¹ For a discussion on portability, see Section 1-4.

6. Elder Exploitation Concerns: Fear of potential elder abuse or financial exploitation;
7. Effective Trustee: Adequacy of a Trustee or co-Trustee that will serve upon the death of the first spouse or while both spouses are living;
8. Disposition of Assets: Acceptance of loss of complete control (i.e., whether both spouses are willing to accept assets subject to trust versus outright control);
9. Legal and Administrative Fees: Acceptance of the time, effort, cost, and aggravation of irrevocable trust planning (e.g., additional income tax returns, need to reflect trust as owner on financial statements that could reduce availability of credit and require legal opinion letters if trust assets are to be used as collateral); and
10. Postnuptial Agreement: Whether the spouses will agree to negotiate and enter into a Postnuptial agreement as part of the restructuring of marital and non-marital assets to reduce the likelihood that the donee spouse, due to the financial windfall from the donor spouse, could be incentivized to seek a dissolution of marriage. A Postnuptial agreement will also address post-dissolution of marriage income tax issues that could result in the inter vivos QTIP trust donor being subject to income tax on trust income distributed to the donor's spouse upon dissolution of marriage for the remainder of the donee spouse's life from the inter vivos QTIP trust based, in part, upon repeal of Code Section 682.² The same adverse tax consequence could result with SLATs if there is no termination of trust distributions to the donee spouse upon dissolution of marriage and/or no tax reimbursement provision.³

Those who review the Additional Factors will most likely make an informed decision as to whether to use inter vivos QTIP trusts, SLATs, or a combination thereof because of such persons predisposition as to one or more of the Additional Factors. For example, a doctor or businessman who has significant asset protection concerns may review the Additional Factors and opt for using inter vivos QTIP trusts notwithstanding the additional potential tax benefits of SLATs, whereas someone with less asset protection concern, but significant future estate tax exposure, may prefer a SLAT, especially with rapidly appreciating assets. Some clients may decide on both options where an inter vivos QTIP trust is used to maximize asset protection and a SLAT is used for estate tax benefits. The remainder of this Chapter describes inter vivos QTIP trusts and SLATs in greater detail.

1-2 BENEFITS OF QTIP TRUSTS

Testamentary QTIP trusts are perhaps the most common form of marital deduction trust. Testamentary QTIP trusts provide the surviving spouse beneficiary with minimum distributions of income for the lifetime of the surviving spouse, can empower the Trustee to make principal distributions to the surviving spouse, and if desired by the first spouse to die can limit the ultimate disposition of remaining QTIP trust assets upon the death of the surviving spouse to such persons among the children and more remote lineal descendants of the first spouse to die who created the QTIP trust. If properly drafted, the testamentary QTIP trust qualifies for an estate tax marital deduction if an election is made on the estate tax return of the spouse creating the testamentary QTIP trust. The ability to direct the ultimate beneficiaries of the testamentary QTIP trust is frequently among the most important factors of including a testamentary QTIP trust as part of an estate plan so the first spouse to die can feel reasonably certain that assets passing to the surviving spouse upon the death of the first spouse will pass upon the death of the surviving spouse to children or more remote lineal descendants of the first spouse to die and not to the surviving spouse's next spouse or, in situations of blended families, to the surviving spouse's children to the exclusion of the children of the first spouse to die.

The rules for structuring a QTIP trust upon a donor's death are generally known and accepted. The creation of inter vivos QTIP trusts are less common, even though such trusts offer superb estate planning opportunities and have many of the same non-tax benefits described above. While the core principles of testamentary and inter vivos QTIP trusts are exactly the same, inter vivos QTIP trusts require additional considerations that are not as well known to those who may not be using inter vivos QTIP trusts on a regular basis.

² For a discussion of post 2017 Tax Act repeal of Code Section 682, See Section 1-10.1. See Exhibit 3 for ACTEC Response to Notice 2018-27, regarding Code Section 682 repeal, which suggest that the consequences of Code Section 682 repeal be effective only for irrevocable trusts created before enactment, excluding additions thereto.

³ See Exhibit 1, Barry A. Nelson and Cassandra S. Nelson, *6 Question 2018 Gift Suitability Analysis*.

This Chapter addresses the benefits and drawbacks for spouses to create inter vivos trusts for one another for enhanced asset protection, estate, gift, and GST tax reduction and income tax basis planning. As discussed in Chapter 7, spousal gifts are an effective asset protection option if properly planned and initiated with an understanding of the associated risks in the event of dissolution of marriage. In determining whether to implement trust planning for spouses, the Additional Factors described above should be carefully considered.

Estate planners and advisors typically understand that the donor spouse of an inter vivos QTIP trust will generally be taxed on all trust income under the grantor trust rules provided in Code Sections 672(e) and 677(a). However, estate planners, advisors, and their clients may be surprised that as a result of repeal of Code Section 682, effective January 1, 2019 by the 2017 Tax Act, grantor trust status and the obligation to pay tax on income paid to the donee spouse of an inter vivos QTIP trust may continue as an obligation of the donor spouse post-dissolution of marriage for the remainder of the donee spouse's life. As a result of Code Section 682 repeal, the donee spouse will no longer be obligated to pay income tax on income distributed to such spouse as beneficiary of an inter vivos QTIP trust if divorce occurs after December 31, 2018.⁴ This consequence requires that a well structured Postnuptial Agreement be included as part of the formation and funding of an inter vivos QTIP trust or at least suggested to clients using an inter vivos QTIP trust.⁵

Numerous articles and presentations have extolled the many benefits of inter vivos QTIP trusts including asset protection, creation of estate tax discounts, and "Superchargingsm." However, estate planners, advisors, and their clients may not focus on the fact that the donor of an inter vivos QTIP trust may have continuing obligations to pay income taxes on post-dissolution of marriage trust income, notwithstanding that the donor may have no rights to trust distributions or access to trust assets to pay such taxes.

1-2.1 What are the general requirements to benefit from asset protection through creation of inter vivos QTIP trusts?

Unlike outright gifts to spouses as described in Chapter 7, gifts to an inter vivos QTIP trust for a spouse can be drafted to allow the donor spouse to make a transfer for the benefit of his or her spouse and can assure the donor spouse that if the donee spouse dies first the donor spouse will receive use of the transferred assets through an asset protected trust provided such trust is created by a donor domiciled in one of the seventeen states, including Florida, that protect donors of inter vivos QTIP trusts when assets return in certain trusts for the benefit of the initial donor if the donee spouse dies first or in one of the seventeen states that have broader self-settled asset protection legislation (see Section 1-3, below). To gain these benefits the donor spouse must create a trust for the benefit of his or her spouse that qualifies for the gift tax marital deduction under Code Section 2523(f), attached as Exhibit 2, and can retain a back-end reversion should the donee spouse die first. The donee spouse must have the right to all trust income payable no less frequently than annually for the lifetime of the donee spouse and such interest must continue even in the event of dissolution of marriage. The donee spouse must be the sole beneficiary of the inter vivos QTIP trust while living and an election to treat the gift as qualified terminable interest property must be made on the donor's timely filed gift tax return as provided in Code Section 2523(f)(2)-(4). Each year a gift is made to the inter vivos QTIP trust an additional timely filed gift tax return should be filed to make the Code Section 2523(f)(4) election.

1-2.2 What are the greatest traps in planning for inter vivos QTIP trust gifts?

Similar to the discussions as to traps for spousal transfers described in Chapter 7, Section 7-1.3, the gift to an inter vivos QTIP trust is irrevocable and the donee spouse continues to receive trust income for his or

⁴ For a discussion on repeal of Code Section 682, see Section 1-10.2. See also Exhibit 4 for American Bar Association Section of Family Law Report to House of Delegates Resolution 102A addressing repeal of Code Sections 215 and 682, adopted by the ABA House of Delegates on August 6-7 at the 2018 Annual Meeting in Chicago.

⁵ For a discussion on pre 2017 Tax Act income tax issues see Barry A. Nelson, Lester Law & Richard S. Franklin, *Seeking and Finding New Silver Patterns in a Changed Estate Planning Environment: Creative Inter Vivos QTIP Planning*, Address at the ABA Section of Real Property, Trust and Estate Law Spring Symposia (May 2, 2014) (and accompanying materials); Jonathan G. Blattmachr, Mitchell M. Gans & Diana S.C. Zeydel, *Supercharged Credit Shelter Trusts versus Portability*, 28 Prob. & Prop. 10 (Mar./Apr. 2014); Diana S.C. Zeydel, *Cutting Edge Estate Planning Techniques: What Have I Learned From My Colleagues?*, NAEPJ. of Est. & Tax Plan. at 29 (2012); Mitchell M. Gans, Jonathan G. Blattmachr & Diana S.C. Zeydel, *Supercharged Credit Shelter Trusts: A Super Idea for Married Couples Especially in Light of the 2010 Tax Act*, AK Tr. Co. Newsl. (May 2011); Barry A. Nelson & Richard R. Gans, *New §736.0505(3) Assures Tax/Asset Protection of Inter Vivos QTIP Trusts*, 84 Fla. Bar J. 50 (Dec. 2010); Mitchell M. Gans, Jonathan G. Blattmachr & Diana S.C. Zeydel, *Supercharged Credit Shelter Trusts*, 21 Prob. & Prop. 52 (July/Aug. 2007).

her lifetime. In addition, as described below, the donor spouse is treated as the grantor of the inter vivos QTIP trust for income tax purposes and must report trust income. Before the enactment of the 2017 Tax Act, Code Section 682 provided that upon dissolution of marriage, the donee spouse must pay income tax on distributed income from a trust that otherwise was a grantor trust taxed to the donor spouse and the donor spouse continued to be subject to income tax on undistributed capital gains as described in Section 1-10, below. The 2017 Tax Act repealed Code Section 682 effective January 1, 2019.⁶ Unless Code Section 682 repeal is modified by Congress or the results of the 2017 Tax Act are addressed and modified through a Postnuptial Agreement or a Marriage Settlement Agreement to require that the donor spouse be reimbursed by the donee spouse, inter vivos QTIP trusts create a tax liability for the donor spouse, even after dissolution of marriage. Furthermore, unless and until the post-2017 Tax Act law is clarified, a possible interpretation of Code Section 672(e)(1)(A) (the “spousal unity rule”) results in the donor of an inter vivos QTIP trust being subject to income tax on all trust income post-dissolution of marriage (including capital gains) even if the donor spouse does not reserve the right to trust assets upon the death of the donee spouse.⁷

1-2.3 What are the greatest traps for professionals advising clients to create inter vivos QTIP trusts?

Creation of an inter vivos QTIP trust is similar to any spousal transfer because one spouse (the donor) is irrevocably transferring assets to his or her spouse (the donee). An advantage of an inter vivos QTIP trust is that the donor spouse can reserve an asset protected remainder in trust if the donee spouse predeceases him or her in any of the 17 states, including Florida, that enacted such protection, as described in Section 1-3. Nevertheless, at least for the lifetime of the donee spouse, trust income must be paid to the donee spouse no less frequently than annually and the donee spouse must be the sole beneficiary until the donee spouse’s death.

As described in Section 1-2.2, post-dissolution of marriage, the donor spouse can be subject to significant income taxes on trust income and capital gains without receipt of funds to pay such tax. Further, professionals must be certain to advise the donor that a gift tax return must be filed by April 15th of the year after the gift is made and each year an addition is made to such trust in order to make a timely election to treat the trust and any additions thereto as a QTIP trust under Code Section 2523(f) so that such gifts qualify for the gift tax marital deduction. As of the time of publication, there is no mechanism to correct a late filed gift tax return and the result is that the entire value of the gift to the QTIP trust for such year is a taxable gift. In the event the gift exceeded the donor’s remaining Basic Exclusion Amount (\$11.4 million for 2019 less prior taxable gifts) gift tax would be imposed at 40%. Further, under Florida law (and the law of most states adopting similar legislation) the favorable asset protection benefits of inter vivos QTIP trusts are contingent upon making the Code Section 2523(f) election. As a result, failure to satisfy such election will likely result in loss of asset protection. Income tax issues should be addressed in a Postnuptial Agreement at the same time the QTIP trusts are created and funded or in the event of dissolution of marriage, in the Marriage Settlement Agreement.

1-3 PLANNING USING INTER VIVOS QTIP TRUSTS

Seventeen (17) states, but not Florida, have enacted broad self-settled asset protection trust statutes, which are discussed in Chapter 10.⁸ Residents of such states can rely on their state’s public policy to take advantage of self-

⁶ Lewis J. Saret, *Notice 2018-37, IRB 2018-18: Continued Application of Repealed Code Sec. 682 to Certain Alimony Trusts*, Wealth Strategies (April 13, 2018), available at <http://www.wealthstrategiesjournal.com/notice-2018-37-irb-2018-18-continued-application-of-repealed-code-sec-682-to-certain-alimony-trusts/>. See also full Notice 2018-37, Bulletin No. 2018-10 (March 5, 2018) available at <https://www.irs.gov/pub/irs-irbs/irb18-10.pdf>.

⁷ Notice 2018-37, 2018-18 IRB 392, released on April 13, 2018 requested comments on this issue following a divorce or legal separation in light of repeal of Code Section 682. As of the date of this publication, this issue is not resolved. See Exhibit 3 for ACTEC response to Notice 2018-37. See Exhibit 4 for American Bar Association Section of Family Law Report to House of Delegates Resolution 102A addressing repeal of Code Sections 215 and 682 (Adopted August 6-7, 2018 at the 2018 Annual Meeting in Chicago).

⁸ ALASKA STAT. §§ 13.36.310, 34.40.110; DEL. CODE ANN. TIT. 12, §§3570-3576; HAW. REV. STAT. § 554g; Mich. Comp. Laws 700.1041-.1050; Miss. Code Ann. §§91-9-701 – 91-9-723; MO. REV. STAT. §§456.5-505; N.H. REV. STAT. ANN. § 564-B:5-505A(E)(3)-(4); NEV. REV. STAT. §§116.010-166.170; OHIO LEGACY TRUST ACT, CHAPTER 5816 OF THE OHIO REVISED CODE; OKLA. STAT. ANN. Tit. 31, § 10-18; R.I. GEN. LAWS § 18-9.2-1 – 18-9.2-7; S.D. CODIFIED LAWS §§55.16-1–55-16-17; TENN. CODE ANN. § 35-16-101-112; UTAH CODE ANN. §25-6-14 (Repealed And Re-Enacted In 2013); VA. CODE ANN. § 64.2-745.1 and 64.2-745.2; W. VA. CODE SECTIONS 44D-5-503A, 44D-5-503B; 44D-5-503C; AND 44D-5-505; WYO. STAT. §§4-10-505 & 4-10-510–523. See “ACTEC Comparison of the Domestic Asset

settled asset protection benefits. Florida and sixteen (16) other states, including six (6) with broad self-settled asset protection trust legislation, have enacted statutes that create limited self-settled asset protection for trusts created under Code Section 2523(f) (inter vivos QTIP trusts) and/or trusts created under Code Section 2523(e) (life estates with power of appointment in donee spouse) that are held for a donee spouse but revert to the donor spouse if the donee spouse dies first either by the exercise of a power of appointment or through a reversion.⁹ A number of cases have challenged whether a debtor living in a state that has not enacted self-settled asset protection legislation can use and safeguard assets in a domestic asset protection trust created in a state, other than the domicile state of the debtor, that has enacted said legislation.¹⁰ Section 4, Comment 8, of the Uniform Voidable Transactions Act (“UVTA”), which has not been enacted in Florida but is under consideration, provides that a transfer to a self-settled domestic asset protection trust is voidable if the transferor’s home state does not have domestic asset protection trust legislation.¹¹ As of September 2018, nineteen (19) states have enacted the UVTA.¹² The UVTA has been introduced in five (5) states.¹³

Florida modified its spendthrift trust statute in 2010 to provide that where an inter vivos QTIP election was made, then, after the death of the donor’s spouse, any assets passing back into a trust for the initial donor spouse pursuant to the inter vivos QTIP trust agreement are deemed to have been contributed by the donee spouse and not by the donor spouse.¹⁴ The creation of inter vivos QTIP trusts thereby allows married couples to take advantage of one another’s Basic Exclusion Amounts without the need to rely on portability and, at the same time, enhance asset protection planning while both spouses are living and upon the death of the first spouse. These statutes (referred to hereinafter as the “Inter Vivos QTIP Spendthrift Statutes”), coupled with the enhanced Basic Exclusion Amount provided under the 2017 Tax Act, provide estate planners with a great planning opportunity, especially for those with anticipated aggregate estates that will be less than the aggregate Basic Exclusion Amount.

It is critical that possible adverse income tax consequences to the donor spouse of an inter vivos QTIP trust in the event of dissolution of marriage be considered. Unless a Postnuptial Agreement or Marital Settlement Agreement includes a reimbursement provision for income taxes charged to the donor spouse attributable to income paid to the donee spouse during the lifetime of the donee spouse, the donor spouse will be burdened with unanticipated income taxes until the death of the donee spouse that would not have been taxed to the donor spouse before Code Section 682 repeal.

Couples with children from separate marriages, or who otherwise have different views as to ultimate beneficiaries (e.g., where the donor spouse wants his or her alma mater to receive the bulk of family wealth upon the death of the donee spouse and the donee spouse has other intentions), can achieve their dispositive objectives through gifts in trust for the donee spouse that provide for the disposition of trust assets upon the death of the donee spouse. Once the decision is made to use a trust for a spousal gift, factors discussed in this Chapter need consideration as an inter vivos QTIP trust can be drafted to assure that the initial donor spouse (or his or her children) benefit from trust assets upon the death of the initial donee spouse. However, an inter vivos QTIP trust does not freeze asset values as of the date of the initial trust funding. Instead assets gifted to an inter vivos QTIP trust will be included in the gross

Protection Trust Statutes,” updated through August 2017, edited by David G. Shaftel. As noted by the ACTEC Comparison, it is unclear whether Colorado should be considered an asset protection trust jurisdiction.

⁹ Eleventh Annual ACTEC Comparison of the Domestic Asset Protection Statutes, updated through August 2017, Edited by David G. Shaftel, www.actec.org/assets/.../Shaftel-Comparison-of-the-Domestic-Asset-Protection-Trust.

¹⁰ See *In re Mortensen*, A09-00565-DMD, 14 (Bankr. D. Alaska May 26, 2011) (an unreported decision); *Waldron v. Huber (In re Huber)*, BK. W.D. Wa Adversary No. 12-04171, Bankruptcy No. 11-41013, Order Granting Trustee Partial Summary Judgment, Doc. 142, May 17, 2013 (the “Order”). For further discussion, see Chapter 10.

¹¹ Uniform Voidable Transactions Act (Formerly Uniform Fraudulent Transfers Act) (As Amended in 2014). See also Chapter 15 for a discussion on fraudulent transfers.

¹² Alabama, Arkansas, California, Georgia, Idaho, Indiana, Iowa, Kentucky, Michigan, Minnesota, New Mexico, North Carolina, North Dakota, Pennsylvania, Rhode Island, Utah, Vermont, Washington, West Virginia. See *Legislative Fact Sheet – Voidable Transactions Act Amendments (2014) – Formerly Fraudulent Transfer Act*, Uniform Law Commission, available at [http://www.uniformlaws.org/LegislativeFactSheet.aspx?title=Voidable Transactions Act Amendments \(2014\) - Formerly Fraudulent Transfer Act](http://www.uniformlaws.org/LegislativeFactSheet.aspx?title=Voidable%20Transactions%20Act%20Amendments%20(2014)%20-%20Formerly%20Fraudulent%20Transfer%20Act).

¹³ Florida, Massachusetts, New Jersey, New York, South Carolina. See *Legislative Fact Sheet – Voidable Transactions Act Amendments (2014) – Formerly Fraudulent Transfer Act*, Uniform Law Commission, available at [http://www.uniformlaws.org/LegislativeFactSheet.aspx?title=Voidable Transactions Act Amendments \(2014\) - Formerly Fraudulent Transfer Act](http://www.uniformlaws.org/LegislativeFactSheet.aspx?title=Voidable%20Transactions%20Act%20Amendments%20(2014)%20-%20Formerly%20Fraudulent%20Transfer%20Act). For further discussion of the UVTA see Section 15-2.

¹⁴ See FLA. STAT. § 736.0505(3). See also Barry A. Nelson and Richard R. Gans, *New §736.0505(3) Assures Tax/Asset Protection of Inter Vivos QTIP Trusts*, Fla. Bar J. (Dec. 2010), available at <http://www4.floridabar.org/DIVCOM/JN/JNJournal01.nsf/8c9f13012b96736985256aa900624829/3a052d456397f681852577ea005aab79!OpenDocument>.

estate of the donee spouse under Code Section 2044 and in most cases benefit from up a step up in income tax basis.¹⁵ As long as the combined value of both spouses assets are not likely to exceed their combined Basic Exclusion Amounts, inter vivos QTIP trusts are an excellent alternative. An inter vivos QTIP trust maximizes income tax basis step-up because, to the extent assets are included in a donee spouse's gross estate and covered by the Basic Exclusion Amount of the first to die, there is no transfer tax and such assets benefit from a step-up in income tax basis. If, however, it is likely that family assets will exceed the Basic Exclusion Amounts of both spouses, inter vivos spousal gifting may be made through SLATs, as described in Section 1-7, below, or a combination of SLATs and inter vivos QTIP trusts with the objective that the aggregate taxable estates of both spouses will not exceed both spouses Basic Exclusion Amounts.

1-3.1 Dennis and Debbie—An Example

In order to illustrate the planning possibilities of an inter vivos QTIP trust for a couple concerned about asset protection that does not anticipate aggregated estates equal to or significantly above their combined Basic Exclusion Amounts, a hypothetical example is provided.

Dennis and Debbie, both attorneys, are married with children and reside in Florida. Dennis and Debbie have accumulated a net worth of \$23.8 million, of which \$3.8 million is equity in their Florida homestead, and \$20 million is invested in a joint brokerage account (titled “tenants by the entirety”). Dennis and Debbie are willing to rely on estate tax portability to maintain a “simple” estate plan and benefit from asset protection provided by tenants by the entireties ownership while both of them are living and married to one another. Assuming Debbie died in January of 2019 and Dennis died in March of 2019, no estate tax is due upon Debbie's death and the tax upon Dennis' death, assuming portability, would be \$400,000 (Dennis' taxable estate of \$23.8 million - \$22.8 million Applicable Exclusion Amount = \$1 million x 40% tax rate = \$400,000).¹⁶ All of their assets are protected from creditors during their joint lifetimes (assuming all debts are owed to persons other than the IRS or SEC (as to disgorgement orders), or another federal agency with collection powers similar to the IRS or SEC, they had no joint debt, and there was no fraudulent conveyance to the tenancy by the entirety accounts. However, upon the death of Debbie, all assets that pass outright to Dennis by operation of law, other than their Florida homestead (which we assume qualified for Florida's constitutional unlimited homestead exemption as to creditors), would be subject to Dennis' creditors.

In order to enhance the amount of assets that can pass free of estate tax upon the death of the surviving spouse, assuming future appreciation, by allowing the assets of a “Credit Shelter Trust” to grow, their CPA suggests that Debbie's assets be re-titled so the revocable trust created by Dennis owns \$10 million (thereby avoiding probate and taking advantage of his Basic Exclusion Amount if he dies first), and the revocable trust created by Debbie owns \$10 million.¹⁷ Each of their revocable trusts creates a testamentary Credit Shelter Trust primarily for the benefit of the surviving spouse of the greatest amount that can pass free of estate tax upon the death of the first spouse, which trust is intended to pass free of estate tax upon the death of the surviving spouse. Although this may be the most common estate plan for those who were married before the enactment of portability, for the reasons described, below, this plan creates numerous tax and asset protection shortfalls based upon portability, the enhanced Basic Exclusion Amount, and income tax basis considerations and the loss of tenants by the entirety asset protection while both spouses are living and married to one another.¹⁸

Dennis and Debbie's desire is to maintain access to all family wealth until the survivor of them passes away, but they do not mind having a portion of the funds held in trust for the surviving spouse, as long as the surviving spouse can serve as a co-trustee or as sole trustee during his or her lifetime, and as long as distributions can be made to the surviving spouse based upon an ascertainable standard (such as for his or

¹⁵ Code Section 1014(e) limits the step-up in income tax basis if (i) appreciated property was acquired by the decedent by gift during the 1-year period ending on the date of the decedent's death, and (ii) 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). See also Kevin M. Chen and David A. Handler, *The Estate Trust Revival: Maximizing The Full Basis Step-Up For Spouses*, *Trusts & Estates Magazine* (July 2001) and John J. Scroggin, *Understanding Section 1014(e)*, *LISI Estate Planning Newsletter* #2192 (Feb. 6, 2014) at <http://www.naepjournal.org/journal/issue17j.pdf>.

¹⁶ See Exhibit 5, Dennis and Debbie – Tenancy by the Entireties Plan.

¹⁷ See Exhibit 6, Dennis and Debbie—CPA's Tax Savings Plan.

¹⁸ Portability was first introduced as part of the Tax Relief Unemployment Reauthorization, and Job Creation Act of 2010, and became effective for married persons dying on or after January 1, 2011. Portability was scheduled to “sunset” on December 31, 2012 but became permanent as a result of the enactment of the American Taxpayer Relief Act of 2012. For a discussion on portability see Section 1-4.

her health, maintenance and support). Assuming they follow their CPA's suggestion and divide their assets so each has \$10 million in their respective revocable trusts, none of the \$10 million owned by each of their respective trusts would be protected from creditors while both spouses are married and living because assets in a revocable trust are not protected from creditors' claims.¹⁹ Assuming Debbie predeceases Dennis and no significant claims are made against her estate, Debbie's assets can pass into a Credit Shelter Trust for Dennis with spendthrift protection that would be generally protected from Dennis' creditors. During Dennis' life, \$10 million or more (i.e., the assets held in the Credit Shelter Trust for the benefit of Dennis as well as any growth and accumulated income) is protected from his creditors, but the \$10 million held in the revocable trust created by Dennis (plus all appreciation) remains subject to his creditors.²⁰ Based upon the assumptions above, upon his death, Dennis' estate would pay \$400,000 in estate taxes assuming no appreciation on his \$10 million investments and his \$3.8 million homestead residence.²¹

Dennis and Debbie want a second opinion, so they consult with Mike, an attorney whose practice combines estate planning and asset protection. Mike explains that converting \$20 million of their assets from tenants by the entirety into two \$10 million revocable trust accounts changes the character of the assets from those that are protected from most potential creditors under applicable Florida law (as long as the debt was not a joint debt of Dennis and Debbie, and both were living and married to one another), and subjects the entire \$20 million to claims of their respective creditors because assets in a revocable trust are unprotected.²² Dennis and Debbie ask for alternatives that would allow each of them to take advantage of their Basic Exclusion Amounts while at the same time not subjecting their assets to exposure to the claims of future creditors. They have also heard there may be income tax benefits using certain irrevocable inter vivos trusts.

Mike explains that as a result of the enactment of Florida's inter vivos QTIP trust statute (which has been adopted in various versions but with similar objectives in seventeen states), assuming Dennis and Debbie have no then existing actual or contingent liabilities,²³ Dennis and Debbie can divide their \$20 million tenants by the entireties brokerage account equally between them and create separate inter vivos QTIP trusts, taking care that the trusts are not reciprocal.²⁴ Florida Statutes Section 736.0505(3) provides a solution to many of Dennis and Debbie's tax and asset protection objectives. Rather than maintaining the assets in unprotected revocable trusts (and thereby subjecting \$20 million of assets to potential future

¹⁹ See *id.* Most of the inter vivos QTIP trust jurisdictions provide statutorily that assets in a revocable trust are not protected from creditors' claims, see Ariz. Rev. Stat. § 14-10505(A)(1); Del. Code Ann. Tit. 12 § 3536(d)(3); Fla. Stat. § 736.0505(1)(a); Mich. Comp. Laws § 700.7506(1)(a); N.C. Gen Stat. § 36C-5-505(a)(1); OR. Rev. Stat. § 130.315(1)(a); S.C. Code Ann. § 62-7-505(a)(1); Va. Code Ann. § 64.2-747(A)(1); Wyo. Stat. Ann. § 4-10-506(a)(i).

²⁰ See Exhibit 6, Dennis and Debbie – CPA's Tax Savings Plan.

²¹ Dennis' Gross Estate (\$13.8 million, \$10 million of brokerage assets and \$3.8 million in equity from homestead) – Applicable Exclusion Amount (\$11.4 million from Dennis' Basic Exclusion Amount and \$1.4 million from portability because Debbie used only \$10 million of her Basic Exclusion Amount = \$12.8 million) = Dennis' Taxable Estate (\$1 million). Dennis' Estate Tax is \$400,000 (\$1 million x 40 percent). See Exhibit 8.

²² FLA. STAT. § 736.0505(1)(a) (“The property of a revocable trust is subject to the claims of the settlor's creditors during the settlor's lifetime to the extent the property would not otherwise be exempt by law if owned directly by the settlor”). See Exhibit 9.

²³ While Dennis and Debbie enjoy tenancy by the entireties protection of their jointly owned assets, once Debbie and Dennis separate their tenants by the entirety property so each of them owns one half in their own names, the tenancy by the entireties protection is lost. In the event either Debbie or Dennis had any outstanding creditors at that time, breaking the tenancy by the entirety would subject any assets held in the sole name of Debbie or Dennis to claims of their creditors and a conveyance by them to an inter vivos QTIP trust at a time where either of them is insolvent could be deemed a fraudulent conveyance, thereby subjecting the transfer to attachment or other creditors' remedies. See FLA. STAT. §§726.105; 726.108. See Section 1.3., above, for the seventeen states that have inter vivos QTIP spendthrift statutes.

²⁴ This should only be done if Dennis and Debbie do not have existing debt because once assets held as tenants by the entirety are divided and retitled in their respective names, assets that previously were protected from creditors as tenants by the entirety (assuming no joint debt) would be subject to creditors' claims of Dennis and Debbie since they will have outright ownership of \$11.4 million each prior to contributing such assets to the new QTIP trusts. Reciprocal trusts must be avoided (see Section 1-9.4). Accordingly, Dennis and Debbie should contribute different amounts to the inter vivos QTIP trusts they create. Such trusts should not be created at the same time. Further, the transfers to the inter vivos QTIP trusts should not render Debbie or Dennis insolvent. Florida Statute Section 726.103 defines “insolvency” as follows: “A debtor is insolvent if the sum of the debtor's debts is greater than all of the debtor's assets at a fair valuation.” For a more detailed discussion on fraudulent conveyances and solvency, see Chapter 15, Sections 15-1.2.2 and 15-3. Florida Statute Section 726.102(2) defines “assets” and excludes property generally exempt under nonbankruptcy law and tenants by the entirety property. Thus, care must be taken to retain sufficient assets that are not exempt from creditors' claims to satisfy current and contingent liabilities to avoid a fraudulent conveyance (See Chapter 15). For an excellent article addressing the reciprocal trust issue in great detail, see Mitchell M. Gans, Jonathan G. Blattmachr & Diana S.C. Zeydel, *Supercharged Credit Shelter Trust*, 21 PROB. & PROP. 52, 57-62 (July/Aug. 2007).

creditors) while both Dennis and Debbie are living, Dennis can create an inter vivos QTIP trust for Debbie and transfer \$10 million of assets to the trust, and Debbie can do the same for Dennis.²⁵

Dennis would only be willing to create the trust for Debbie if he had reasonable assurances that, should Debbie predecease Dennis, he would have access to the \$10 million (or such other amount as may be held in the trust) upon Debbie's death. To maintain flexibility for future planning, the inter vivos QTIP trust can give Debbie a testamentary non-general power of appointment that could be exercised in favor of one or more of Dennis, their children, or a charity.²⁶ However, if Dennis wants to be certain that, should Debbie predecease him, the assets would be held in a trust for him, the inter vivos QTIP trust could provide that if Dennis survives Debbie, assets remaining in Debbie's inter vivos QTIP trust must pass in trust for the benefit of Dennis during his lifetime. The trust for the benefit of Dennis could provide a formula so that to the extent assets that were held in Debbie's trust upon her death can pass free of estate tax as a result of Debbie's remaining Basic Exclusion Amount, such assets would pass into a Credit Shelter Trust for Dennis with any excess assets passing into an inter vivos QTIP trust for Dennis so no estate tax would be payable upon Debbie's death.²⁷ However, in light of portability and to maximize the benefits of step up in income tax basis upon the death of the survivor of Dennis and Debbie, they may instead mandate that upon Debbie's death all assets pass into a trust for the benefit of Dennis, if Dennis survives Debbie, that qualifies for the inter vivos QTIP election upon Debbie's death. Such a plan provides maximum post-mortem planning opportunities because Debbie's personal representative can decide whether to make a QTIP election upon Debbie's death if Dennis survives Debbie.

No QTIP election is required upon Debbie's death for Dennis to have a protected trust because whether or not a QTIP election is made, assets passing back to Dennis in a trust will, upon Debbie's death, be treated as if Debbie, not Dennis, created the trust held for the benefit of Dennis even though Dennis created the trust instrument. If it is unlikely that Dennis's gross estate, taking into account the inclusion of Debbie's trust assets upon Debbie's death, will exceed Dennis's Applicable Exclusion Amount, post-mortem planning upon Debbie's death may suggest making a QTIP election for assets passing back to Dennis to provide a full step up in income tax basis upon Dennis' death. However, if it appears likely that the assets passing in trust for the benefit of Dennis upon Debbie's death are likely to appreciate, or if when combined with Dennis' assets, will exceed Dennis' Applicable Exclusion Amount, then it may be better not to make a QTIP election for assets passing in trust for Dennis upon Debbie's death.

Other factors, such as the likelihood that the Basic Exclusion Amount could be reduced by future legislation, should also be considered.²⁸ Use of an inter vivos QTIP trust created by Dennis for Debbie assures that the assets held in the inter vivos QTIP trust for the benefit of Debbie are protected from her creditors during Debbie's lifetime because the QTIP trust is a third party created spendthrift trust. Furthermore, upon Debbie's death, the assets conveyed for Dennis from Debbie's QTIP trust will be held in an asset-protected spendthrift trust for the benefit of Dennis (a trust for Dennis that qualifies for the estate tax QTIP election at the discretion of Debbie's personal representative).²⁹

²⁵ Even if the amount gifted to the new inter vivos QTIP exceeded \$11.4 Million, no gift tax would be payable assuming a gift tax marital deduction is claimed.

²⁶ A Non-general power of appointment provides the power holder with the right to distribute property, subject to the power, to a limited class of beneficiaries or alternatively to a broad class that excludes the power holder, the power holder's estate, the power holder's creditors, or the creditors of the power holder's estate. *See* I.R.C. § 2041.

²⁷ The mandatory reversion in favor of Dennis would be even more critical if he had children from a prior marriage and he wanted to be certain that upon Debbie's death the assets would: a) pass for his benefit if he survives Debbie; or b) to his children if he predeceases Debbie or disclaims the interest otherwise passing to him upon Debbie's death.

²⁸ *See* Exhibit 1 Barry A. Nelson and Cassandra S. Nelson, *6 Question 2018 Gift Suitability Analysis* and Section 1-1, above.

²⁹ This Chapter assumes assets in a spendthrift trust are protected from general creditors. Exception creditors, such as the IRS, may circumvent spendthrift protection. *See* FLA. STAT. § 736.0503(2), which provides: "For purposes of this section: (a) During the period the power may be exercised, the holder of a power of withdrawal is treated in the same manner as the settlor of a revocable trust to the extent of the property subject to the power. (b) Upon the lapse, release, or waiver of the power, the holder is treated as the settlor of the trust only to the extent the value of the property affected by the lapse, release, or waiver exceeds the greater of the amount specified in: 1. Section 2041(b)(2) or s. 2514(e); or 2. Section 2503(b) and, if the donor was married at the time of the transfer to which the power of withdrawal applies, twice the amount specified in s. 2503(b), of the Internal Revenue Code of 1986, as amended. A spendthrift provision is unenforceable against: (a) A beneficiary's child, spouse, or former spouse who has a judgment or court order against the beneficiary for support or maintenance. (b) A judgment creditor who has provided services for the protection of a beneficiary's interest in the trust. (c) A claim of this state or the United States to the extent a law of this state or a federal law so provides. *See also* Barry A. Nelson, *Protecting*

Until enactment of the inter vivos QTIP spendthrift statutes, such as Florida Statute Section 736.0505(3), assets passing from the inter vivos QTIP trust created by Dennis for Debbie back to a trust for Dennis at Debbie's death, whether based upon the terms of the original trust or through the exercise of a power of appointment by Debbie, may have been subject to the claims of creditors of Dennis because he created the original trust and upon Debbie's death the assets reverted in trust back to him.³⁰ In his defense against a creditor's challenge to the trust, Dennis would argue that Debbie, and not Dennis, should be considered the donor of the trust after Debbie's death. This argument is consistent with Treas. Reg. Section 25.2523(f)-1(f), Example 11, which provides that assets held in an inter vivos QTIP trust for the benefit of the donor after the death of his or her spouse will not be includible in the donor's taxable estate under Code Sections 2036 and 2038.³¹ Under Florida Statute Section 736.0505(3) and similar laws in 16 other states, upon Debbie's death, Debbie, rather than Dennis, should be considered the donor of the new trust created for Dennis.³²

Prior to the enactment of Florida Statute Section 736.0505(3), if Dennis retained the right to the assets remaining in Debbie's inter vivos QTIP trust upon Debbie's death should Debbie predecease Dennis, Dennis' creditors would argue such assets should be subject to Dennis' creditors because he was the initial donor of the trust. Furthermore, under prior Florida law even if the trust created by Dennis did not reserve an interest in favor of Dennis as described above, should Debbie predecease him, if Debbie had a testamentary power of appointment that allows her to direct assets back to Dennis, those assets may be subject to his creditors as a result of the Relation Back Doctrine. It should be noted that although Florida Statutes Section 736.0505(3) protects assets passing to the initial donor spouse if the assets were initially gifted to a QTIP trust, such section does not apply to a SLAT.³³

If the inter vivos QTIP trust created by Dennis in the example above was properly drafted — and assuming (i) the initial transfer to the trust was not a fraudulent conveyance and (ii) a timely QTIP election was made, it is clear that the assets of the inter vivos QTIP trust created by Dennis for the benefit of Debbie will be protected from Debbie's creditors and upon Debbie's death if Dennis survives Debbie, assets passing back to Dennis in a spendthrift trust will be considered as if settled by Debbie and therefore, will not be subject to Dennis' creditors upon the death of Debbie. As long as the assets in the trust created by Dennis are not subject to Dennis' creditors when such assets revert in trust for the benefit of Dennis upon Debbie's death, such assets should not be includible in Dennis' taxable estate assuming Dennis is not provided a general power of appointment to vest trust assets to Dennis, his estate, or his creditors.³⁴ Further, there is concern that even providing the original donor with a non-general power of appointment as to assets returning to the original donor in trust upon the death of the original donee could result in estate tax inclusion.³⁵ While there is no clear answer to this question and those who have written on the topic have different views, a conservative approach is to avoid giving the original donor even a non-general power of appointment if assets return to the original donor through a spendthrift trust upon the death of the original trust donee. Using the inter vivos QTIP plan, \$0 of assets will be subject to creditors' claims while both spouses are married and living, and \$0 of assets should be subject to creditors upon death of first spouse or dissolution of marriage.³⁶ Similar results may be available, using the seventeen states that have self-settled

Trusts From Claims of Alimony or Child Support, *Trusts & Estates Magazine* (March 2014), where a third party created Florida trust could be subject to garnishment as to former spouse with judgment against spouse in the form of support.

³⁰ Fla. Stat. Section 736.0505(3).

³¹ Treas. Reg. § 25.2523(f)(1)(f), Ex. 11.

³² *Id.*

³³ See Section 1-7, below, for a discussion on SLATs. ³³ Portability was first introduced as part of the Tax Relief Unemployment Reauthorization, and Job Creation Act of 2010, and became effective for married persons dying on or after January 1, 2011. Portability was scheduled to "sunset" on December 31, 2012 but became permanent as a result of the enactment of the American Taxpayer Relief Act of 2012.

³⁴ See Treas. Reg. § 25.2523(f)-1(d); Howard M. Zaritsky, *Tax Planning for Family Wealth Transfers: Analysis With Forms* ¶ 6.03[3][a], 6-12 (Thompson Reuters/WG/L, 4th ed. 2002 & Supp. Aug. 2011).

³⁵ See Richard S. Franklin, *Chapter 16: Lifetime QTIPS – Why They Should Be Ubiquitous in Estate Planning*, 50th Annual Heckerling Institute on Estate Planning at 16-61. See also Jeffrey N. Pennell, *Estate Tax Marital Deduction*, 843-3rd (BNA) Estates, Gifts, and Trusts, at VI.F.6, note 518, which provides that it is not advisable that the donor retain any power to control or appoint the inter vivos QTIP trust and cites to Battmahr, Zeydel & Gans, "The World's Greatest Gift Tax Mystery Solved," 115 Tax Notes 243 (2007); Howard M. Zaritsky, *Tax Planning for Family Wealth Transfers During Life* (last updated Oct. 2018) at 6.03[2][b] and 6.03[3][b][ii]3.

³⁶ The tax is similar to the CPA Tax Savings plan with the exception of the assets subject to creditors' claims. Dennis' Gross Estate (\$13.8 million, \$10 million of brokerage assets and \$3.8 million in equity from homestead) – Applicable Exclusion Amount (\$12.8 million) = Dennis' Taxable Estate (\$1 million) Dennis' Estate Tax is \$400,000 (\$1 million x 40 percent). See Exhibit 8, Debbie and Dennis – Inter Vivos QTIP.

asset protection trust legislation, but for Florida residents inter vivos QTIP trust planning assures favorable results because of Florida Statute Section 736.0505(3).³⁷ As discussed in Section 1-7, below, a SLAT creates many tax benefits but because SLATs are not subject to the protection of Florida Statutes Section 736.0505(3), they are not as safe from an asset protection viewpoint as Florida inter vivos QTIP trusts designed as described above or in any other state with inter vivos QTIP legislation.

1-4 PORTABILITY

For the year 2019 the Basic Exclusion Amount exempts \$11.4 million of taxable transfers from gift, generation skipping or estate taxes. Married couples benefit from combined exemptions of \$22.8 million. As noted in Section 7-2, portability was enacted in 2010. Portability allows the unused Basic Exclusion Amount of a deceased spouse to be used by a surviving spouse. Prior to the enactment of portability, if a husband or wife did not take advantage of their respective Basic Exclusion Amounts (referred to before 2010 as the “unified credit amount” or the “applicable exclusion amount” during their lifetime or upon death, they were wasted. As a result, planning required the creation of trusts upon the death of the first spouse so that the Basic Exclusion Amount of the first spouse to die could be allocated to a trust, typically referred to as a Credit Shelter Trust for the benefit of the surviving spouse. These trusts allowed the surviving spouse access to trust distributions, but if properly drafted, assets in such trusts were not includible in the gross estate of the surviving spouse. In order to be certain the first spouse to die had sufficient assets to take advantage of his/her Basic Exclusion Amount, clients were advised they needed to divide assets so spouses had sufficient assets in their own name (or in each spouses revocable trust) to take advantage of his or her Basic Exclusion Amount. Couples were also advised to make decisions on occasion to restructure assets previously held by husband and wife as tenants by the entirety, a title that protects the assets against the claims of only one spouse and avoids probate upon the death of the first spouse,³⁸ and instead re-title such assets by placing a portion of such tenants by the entirety assets in the husband’s sole name and a portion in the wife’s sole name or in the names of their respective inter vivos revocable trusts.

While restructuring of assets by transfers to the revocable trusts of each spouse assured use of each spouses Basic Exclusion Amounts, such transfers created asset protection pitfalls. As a result of portability, a surviving spouse can use any portion of his or her deceased spouses unused Basic Exclusion Amount provided an appropriate estate tax filing is made upon the death of the first spouse and the surviving spouse does not remarry. Advisors should review their client’s existing estate plan to determine if it is safer to hold assets in an asset protected format that avoids probate (e.g. as tenants by the entirety or inter vivos QTIP trusts for Florida residents) rather than have their clients hold significant assets in each spouses sole name, or in their respective revocable trusts. It is critical to verify that any restructuring is initiated after confirming that neither spouse has existing or contingent liabilities. If they do, restructuring could subject protected assets to creditor’s claims, such as where one spouse has a contingent claim against him or her and holds already protected tenants by the entirety property. Dividing such property between spouses subjects protected assets to creditor’s claims of the spouse with creditor’s claims where prior to the division such assets were protected under Florida law as discussed in Chapter 7, Section 7-6.

The analysis as to whether to rely on portability is not simple. There are many factors and much has been written about this planning.³⁹ Income tax factors could be more consequential than estate and/or gift tax factors.⁴⁰ For

³⁷ See Kroch et al., *supra* note 34; Jonathan G. Blattmachr, Mitchell M. Gans & Diana S.C. Zeydel, *Supercharged Credit Shelter Trusts versus Portability*, 28 Prob. & Prop. 10 (Mar./Apr. 2014).

³⁸ For a discussion on tenants by the entirety, see Chapter 7, Section 7-6. See also Barry A. Nelson, *Asset Protection & Estate Planning – Why Not Have Both?*, 46 PHILIP E. HECKERLING INSTITUTE ON EST. PLAN. 1704 (Matthew Bender & Co., Inc. Jan. 2012). See also Barry A. Nelson, *Tenancy by the Entireties*, available at <http://www.estatetaxlawyers.com/articles/AssetProtectionAndEstatePlanning.html> (listing each state and differentiating whether the state recognizes tenants by the entirety). See Exhibit 9 for a summary of states having some type of tenants by the entirety protection.

³⁹ See Lester B. Law and Abbot Downing, *Portability, So Many Questions, So Few Answers*, 51st U. Miami Heckerling Institute on Estate Planning (January 2017), available at <http://www.ndba.com/uploads/resources/743/law-fundamentals-of-estate-tax-portability.pdf>; Lester B. Law, *Portability – Act Now to Correct Missed Elections*, Wealth Management.com (September 7, 2017), available at <https://www.wealthmanagement.com/estate-planning/portability-act-now-correct-missed-elections>; Paul S. Lee, *Planning in the Atra-Math: The Best Income and Estate Tax Planning Ideas Today* (March 9, 2016), available at <http://www.cepcweb.org/assets/Councils/Chicago-IL/library/Planning%20in%20the%20ATRA-Math%20Outline%203.23.16.Speaker%20Outline.pdf>; Thomas W. Abendroth, *Portability: Now Available in Generic Form*, Address at the 48th Annual Heckerling Institute on Estate Planning (Jan. 2014); Jonathan G. Blattmachr, Austin W. Bramwell, & Diana S.C. Zeydel, *Portability or No: The Death of the Credit-Shelter Trust*, J. OF TAX. (May 2013); Howard M. Zaritsky & Diana S.C. Zeydel, *New Portability Temp. Regs. Ease Burden on Small Estates, Offer Planning for Large Ones*, J. OF TAX. (Oct. 2012).

⁴⁰ *Id.*

example, assets owned by the surviving spouse outright, rather than in a Credit Shelter Trust, are stepped up to fair market value as of date of death of the surviving spouse for income tax basis purposes. As a result, if a surviving spouse has an estate of \$15 million and benefits from portability so that his or her entire estate will be free from estate tax as a result of the Applicable Exclusion Amount, then if all assets are included in the estate of the surviving spouse no estate tax will be incurred as a result of the Applicable Exclusion Amount. Assuming all assets are included in the estate of the surviving spouse, they will receive a step-up in income tax basis to fair market value as of the date of death of the surviving spouse. If such assets are sold no capital gain would be incurred upon the sale of assets owned by the surviving spouse at death up to date of death values. If, instead, upon the death of the first spouse, assets of \$11 million were devised to a Credit Shelter Trust for the benefit of the surviving spouse and such assets appreciated by \$5 million (to \$16 million) from the death of the first spouse to the death of the surviving spouse and such amounts remained in the Credit Shelter Trust until the surviving spouse's death, then when the children inherit the Credit Shelter Trust assets, they will only have \$11 million of income tax basis. As a result, a capital gain of \$5 million would be incurred upon the sale of such assets upon the death of the surviving spouse for \$16 million. Based upon current capital gains rates of 20%, combined with the Net Investment Income Tax of 3.8%, income taxes of approximately \$1.19 Million could be incurred upon the sale of the \$16 million of assets with \$5 million of appreciation that could have been avoided with planning that used outright gifts to the surviving spouse or an inter vivos QTIP trust where a QTIP election was made, provided that with the appreciation of property in the QTIP trust or assets that passed to the surviving spouse upon the death of the first spouse, the estate of the surviving spouse is less than the Applicable Exclusion Amount of the surviving spouse. Both an outright gift to the surviving spouse upon the death of the first spouse to die or a gift to a QTIP trust (where a QTIP election was made) for the surviving spouse would have resulted in a step-up in income tax basis upon the death of the surviving spouse of the \$5 million of appreciation so the income tax basis would be \$16 million. Upon sale at that price upon the death of the surviving spouse no income tax or estate tax would be payable.

Portability has a number of shortfalls. For example, if the surviving spouse remarries and the new spouse also predeceases him or her, then the availability of the unused Basic Exclusion Amount is based upon the last deceased spouse. As a result, if the first predeceased spouse (Joan) left all of her assets outright to her husband (Sam), and then Sam remarries a wealthy woman (Mary) who already made full use of her Basic Exclusion Amount by making gifts to her children, then if Mary predeceases Sam, Sam will not benefit from portability attributable to Joan's unused exemption. Sam's last deceased spouse (Mary) had no unused Basic Exclusion Amount and accordingly, Sam would have no access to Joan's unused Basic Exclusion Amount.

As noted in Section 1-1, above, and the author's Gift Suitability Analysis⁴¹ there are multiple considerations as to whether it is currently tax efficient to make gifts using the Basic Exclusion Amount based upon the possibility that the Basic Exclusion Amount could be reduced by future legislation.⁴²

The same issues discussed in the Gift Suitability Analysis⁴³ apply in determining whether to use a Credit Shelter Trust upon the death of the first spouse rather than making a gift to an electing testamentary QTIP trust. If estate taxes are repealed and step-up in income tax basis is still available upon death, appreciated assets in a Credit Shelter Trust will be subject to greater future income tax upon sale (because such assets will not benefit from a step-up in income tax basis) as would occur if the assets were owned by the surviving spouse outright or in an electing QTIP trust upon the death of the surviving spouse. Although drafting may be possible to hedge against potential estate tax repeal, such as providing alternative dispositive provisions depending upon whether estate tax is in effect at the date of death of a decedent, such provisions are complex. Furthermore, a trust protector can be empowered over assets in a Credit Shelter Trust to distribute assets that otherwise would not benefit from a step-up in income tax basis outright to a trust beneficiary or to change a non-general power of appointment upon the death of the surviving spouse to a general power of appointment.⁴⁴ However, each of these options creates significant non-tax issues, especially where spouses each have children from prior marriages and could result in increased estate taxes if estate tax is not repealed at such time or if the Basic Exclusion Amount is reduced by Congress. Outright gifts to a surviving spouse, or providing a trust protector with the power to expand a power of appointment in favor of a surviving spouse could result in having the assets pass upon the death of the surviving spouse to the children of the surviving spouse to the detriment of the beneficiaries of the first spouse to die. An option is to provide a general power of appointment requiring consent of a nonadverse party.

⁴¹ See Exhibit 1 Barry A. Nelson and Cassandra S. Nelson, *6 Question 2018 Gift Suitability Analysis*.

⁴² *Id.*

⁴³ *Id.*

⁴⁴ A "non-general" power of appointment (sometimes referred to as a "special" power of appointment) is a power that cannot directly or indirectly benefit a powerholder. A "general" power of appointment, in contrast, can benefit the powerholder.

Another shortfall of portability is that the unused Basic Exclusion Amount transferred to the surviving spouse is not indexed for inflation, and portability does not apply to the GST exemption.⁴⁵ If a surviving spouse lives for an additional ten to twenty years and the assets inherited outright from the first spouse to die significantly appreciate in value, the estate tax on the appreciation upon the death of the surviving spouse could have been avoided if instead the assets were held in a Credit Shelter Trust (to the extent the surviving spouse had other assets available through income and principal distributions from the Credit Shelter Trust and assets held directly or through other trusts for the surviving spouse). Credit Shelter Trusts may also provide asset protection to trust beneficiaries. Thus, using a Credit Shelter Trust, the first spouse can assure that his or her wealth passes as he or she intends and appreciation on assets, as well as a cumulative increase in the Credit Shelter Trust, may pass estate and generation-skipping transfer tax free to children and more remote descendants. The aforementioned benefits are not possible if portability is relied on and assets are conveyed outright to a surviving spouse.

Those who are willing to rely on portability may decide that owning the entire \$22.8 million of assets as tenants by the entirety is a simple plan that avoids probate after the death of the first spouse, especially in states such as Florida where tenants by the entirety assets are protected from claims of creditors that are not joint creditors. However, there are significant risks with the tenants by the entirety plan. First, upon the death of the first spouse, assets are unprotected from creditors of the surviving spouse upon the death of the first spouse. Next, in blended families, there is no assurance the surviving spouse will leave any share to the family of the first spouse to die. In addition, no protection is available through tenancy by the entirety ownership where the entirety holders have joint debt such as loan guarantees signed by husband and wife or joint liability where husband and wife work together in their law or medical practices and both get sued and a joint judgment is rendered against them.⁴⁶ As described in Chapter 7, life insurance can be used as a hedge against the loss of asset protection upon the death of the first spouse as to tenants by the entirety property that passes to the surviving spouse subject to the creditors of the surviving spouse. While the assets held as tenants by the entirety pass to the surviving spouse unprotected from creditor's claims, if the first spouse to die leaves life insurance payable to a trust qualifying for the QTIP election or to a SLAT or life insurance trust, such life insurance proceeds can serve as a wealth replacement in favor of the surviving spouse for the previously protected tenants by the entirety property that could be reached after the death of the first spouse.

1-5 THE RELATION BACK DOCTRINE MUST BE CONSIDERED

1-5.1 The Relation Back Doctrine

The Relation Back Doctrine addresses whether assets passing through the exercise of a power of appointment are considered to pass from the initial donor of the power or from the person who exercises the power.⁴⁷ The Restatement of the Law of Property describes the Relation Back Doctrine as follows: "The donee of the power of appointment likewise has the power to create interest in other persons; but it is the underlying dogma of the law of powers of appointment that such interest constitute transfers from the donor of the power, not from the donee."⁴⁸

For asset protection purposes, the most significant distinction between an inter vivos QTIP trust and a SLAT is that in the 17 inter vivos QTIP jurisdictions if one spouse executes an inter vivos QTIP trust for the other and either reserves an interest if the initial donor survives his or her spouse or provides his or her spouse with a power of appointment, both state law and federal tax law treat the initial donee of the inter vivos QTIP trust as the settlor of the trust created for the initial donor of the inter vivos QTIP trust upon the death of the initial donee of the inter vivos QTIP trust whether such assets pass to the initial donor by direction of the trust or through the exercise of a power of appointment by the initial donee of the inter vivos QTIP trust.⁴⁹ No similar statutes apply to SLATs under the law of most inter vivos QTIP trust jurisdictions and Reg. 25.2523(f)-1(f), Example 11 relates only to inter vivos QTIP trusts.⁵⁰ Accordingly, SLATs may not provide the anticipated estate tax or asset protection benefit if not created in a domestic or

⁴⁵ Thomas W. Abendroth, *Portability: Now Available in Generic Form*, address at the 48th Annual Heckerling Institute of Estate Planning (Jan. 2014) at 1-4. See also Temp. Reg. § 25.2505-2T.

⁴⁶ See Chapter 7, Section 7-6.

⁴⁷ *In re Estate of Wylie*, 342 So.2d 996 (Fla. Dist. Ct. App. 1977).

⁴⁸ *Id.* citing 3 Restatement of Property (1940) Section 318 Comment (b).

⁴⁹ Florida Statute Section 736.0505(3) and Reg. 25.2523(f)-1(f), Example 11.

⁵⁰ See Section 1-7.1 for a discussion of states that enacted statutes that potentially protect SLATs if SLAT assets revert to original donor upon death of donee spouse. The discussion reflects that the asset protection benefits are uncertain and even more uncertain if residents of states that do not have similar legislation use such laws in light of the discussion in Chapter 10, Section 10-4.

foreign asset protection jurisdiction in the event of challenge where assets revert to the initial donor of the SLAT upon the death of the initial donee.⁵¹

The Relation Back Doctrine has been discussed in a number of cases but none of the cases directly address SLATs or inter vivos QTIP trusts. The most frequently cited case is *In re Estate of Wylie* where⁵² a husband created a testamentary trust for his wife. At his death, wife received all the income from the trust for her life and had a general power of appointment over the corpus of the trust at her death.⁵³ The issue on appeal was whether the value of the husband's trust was includible in wife's estate for purposes of determining fiduciary fees because she exercised her general power of appointment by her last will and codicil in favor of her testamentary trusts, and the assets were distributed and paid to the trustees thereof.⁵⁴ The determinative question in *In re Estate of Wylie* was whether the power of appointment should be characterized as an interest in property or merely a mandate or authority to dispose of property.⁵⁵ The court noted that:

The doctrine of relation back, minimizing as it does the importance of the donee of the power, is the mainstay for that rule of law which treats the donee as a mere agent with no property interest. Although under attack by many commentators in the field of future interests, the prevailing view still remains that a general power of appointment is a mere mandate or authority to dispose of property and not an interest in property itself.⁵⁶

In keeping with the historical origin of powers of appointment and the "spirit of the law," the court in *Wylie* held that the power of appointment was an authority to dispose of property and not an interest in property.⁵⁷

In re Estate of Wylie was followed in *In re Jayne H. Kiesewetter*, a case interpreting Florida trust law.⁵⁸ In *Kiesewetter*, a Federal bankruptcy court overruled objections of a debtor to exempt assets in a marital deduction trust held for her benefit that contained a spendthrift clause. Wife had a testamentary general power of appointment over a portion of the trust assets and was entitled to all trust income. The bankruptcy court addressed whether a general testamentary power of appointment constitutes property of a bankruptcy estate regardless of a valid spendthrift provision. The *Kiesewetter* opinion said that the Florida Trust Code incorporates Florida common law of trusts and stated:⁵⁹

"The instructive decision on this point is *In re Estate of Wylie*, 342 So.2d 996 (Fla. Dist. Ct. App. 1977). In *Wylie* the court found that a testamentary power of appointment created no property interest in the donee, the party with the power to exercise the appointment.⁶⁰ Instead, such a power represented 'a mere mandate or authority to dispose of property and not an interest in property itself.'⁶¹ The court in *Wylie* held that the donee was a "mere agent" directed to dispose of the donor's property, and that appointments of such property constitute transfers to the appointee from the donor of the power, not from the donee.⁶² The holding in *Wylie* was followed in *Smith v. Bank of Clearwater*⁶³ (noting that property which is exposed to the exercise of a power of appointment does not become part of the estate of the donee of the power)."

The court in *Wylie* acknowledged that case law is unsettled regarding the concept of donees acting as a "mere agents" and noted that "whether a general power of appointment is to be viewed as a property interest...depends upon the facts of the case, and for what purpose that power is being evaluated."⁶⁴ When

⁵¹ See Section 1-7.

⁵² 342 So.2d 996 (Fla. Dist. Ct. App. 1977).

⁵³ *In re Estate of Wylie*, 342 So.2d at 996-97.

⁵⁴ *Id.* at 998.

⁵⁵ *Id.* at 999.

⁵⁶ *Id.* at 998.

⁵⁷ *Id.*

⁵⁸ *In re Kiesewetter*, Civil Action No. 11-109 (W.D. Pa. Sep. 28, 2011).

⁵⁹ Florida Statute Section 736.0106.

⁶⁰ *In re Wylie*, 342 So.2d at 998-99.

⁶¹ *Id.*

⁶² *Id.* (citing Restatement (Third) of Property Section 318, cmt. b (1940)).

⁶³ *Smith v. Bank of Clearwater*, 479 So.2d 755, 757 (Fla. Dist. Ct. App. 1985).

⁶⁴ *In re Wylie*, 342 So. 2d at 999.

a general power of appointment is presently exercisable by the donee, the donee has immediate access to the appointive property of such that some courts have found an attachable property interest exists in the donee.”

In light of *Wylie*, it appears that a reasonable position can be taken that if SLAT assets pass upon the death of the donee spouse by exercise of a testamentary special power of appointment provided to the donee spouse, to a trust for the initial donor spouse that the assets in such trust for the initial donor spouse, will be considered a self-settled trust under Florida law subject to the claims of creditors of the initial donor spouse even if the trust has a spendthrift provision. Creditors of the initial donor upon the termination of the interest of the initial donee would then have access to trust assets to the extent the trustee has discretion or is directed to make distributions to the initial donor spouse based upon the assumption that such power in favor of the trustee will be exercised to the maximum extent of discretion provided to the trustee.⁶⁵

Due to uncertainty as to whether assets reverting back to the initial donor of a SLAT under Florida law and the law of any state that does not have domestic asset protection legislation, SLATs should be created in states that protect self-settled asset protection trusts if it is intended that upon the death of the initial donee spouse assets will be appointed to or otherwise revert to the initial donor spouse. The protection provided for inter vivos QTIP trusts as to reversions back to the initial donor spouse in inter vivos QTIP trust jurisdictions, such as Florida, makes inter vivos QTIP trusts the better option as compared to SLATs if asset protection, and not estate tax savings is the principal objective.

For example, based upon the fact pattern for Dennis and Debbie in Section 1-3.1, above, without the protection provided under Florida Statute Section 736.0505(3), if upon Debbie’s death she exercises a Non-general power of appointment over assets held in an inter vivos QTIP trust created by Dennis to create a Credit Shelter Trust or QTIP trust for Dennis (the initial donor), the trust assets appointed in trust for the benefit of Dennis would be considered to be held in a self-settled trust for Dennis under the Relation Back Doctrine and therefore subject to the claims of Dennis’s creditors. Dennis’ creditors, under the Relation Back Doctrine, could argue: (i) the exercise of a Non-general power of appointment by Debbie constitutes a transfer “from the donor (Dennis) of the power, not from the donee⁶⁶ of the power (Debbie)” and (ii) the power of appointment is “conceived to be merely an authority to the power holder to do an act for the creator of the power.”⁶⁷ “The appointment is said to ‘relate back’ to the time of the creation of the power (i.e., the date the initial QTIP trust or SLAT was created by Dennis) and to operate as if it had been originally contained in [the creator of the power’s] will.”⁶⁸

There are few cases addressing the Relation Back Doctrine and the *Wylie* case addressed whether the power of appointment was an asset subject to fiduciary fees. The *Kiesewetter* case was the first case located by the author that directly addresses creditor’s rights issues. Other than commentary, very little additional authority discusses the Relation Back Doctrine. Alexander Bove’s Fall 2010 ACTEC Journal article that refers to the “relation back” doctrine states:⁶⁹

“This doctrine holds that a transfer that is the subject of the exercise of a power is *not* a transfer by the powerholder (as she has no interest to transfer) but rather it is a continuation of the transfer made by the donor (here the settlor/husband) and completed by the powerholder under authority given to her by the donor... Thus, it is not clear that a court would actually hold that it was a transfer from the donor to a trust for his own benefit through a powerholder’s discretionary exercise of a power of appointment, but it is a risk.”⁷⁰

The sparsity of cases on the Relation Back Doctrine adds to the uncertainty as to result. Accordingly, those using SLATs and inter vivos QTIP trusts in jurisdictions that do not specifically address whether trust assets that pass back to the initial trust donor spouse upon the death of the initial trust beneficiary spouse

⁶⁵ Florida Statute Section 736.0505(1)(b).

⁶⁶ *In re Estate of Wylie*, 342 So.2d 996, 998 (Fla. 4th DCA 1977) (quoting RESTATEMENT (FIRST) OF PROPERTY § 318 comment (b) (1940)).

⁶⁷ American Law Institute, *Donative Transfers* vol. 2 §§ 11.1-24.4, in RESTATEMENT (SECOND) OF PROPERTY 4 (1986).

⁶⁸ *Id.*

⁶⁹ Alexander A. Bove, Jr., *Using the Power of Appointment to Protect Assets – More Power Than You Ever Imagined*, American College of Trust and Estate Counsel Journal, 36 ACTEC 333 (Fall 2010).

⁷⁰ *Id.*

through the exercise of a power of appointment are considered to be self-settled by the initial donor spouse take a risk that such assets will be considered to be self-settled when they return to the initial trust donor spouse if the initial trust beneficiary spouse predeceases the donor.

Although none of the reported cases regarding the Relation Back Doctrine address its application to the donor of a QTIP or SLAT who receives trust assets upon the death of the donee spouse through the exercise of a non-general power of appointment, Florida Statutes Section 736.0505(3) eliminates a Relation Back argument as to electing inter vivos QTIP trust because Florida law specifies that for inter vivos QTIP trusts, where an appropriate gift tax election was made, the initial donee spouse is deemed to be the settlor of the trust passing to the initial donor spouse upon the death of the initial donee spouse.

Florida Statute Section 736.0505(3) is limited to inter vivos QTIP trusts so the Relation Back Doctrine could still be asserted by a creditor to show that if assets gifted to a SLAT return to the initial donor spouse through a spendthrift trust upon the death or renunciation by the initial donee of the SLAT whether by the trust instrument or by exercise of a power of appointment, such assets should be considered to be held in a self-settled trust and therefore not protected from the initial donor's creditors to the extent a trustee has discretion to make distributions to the initial donor spouse. For this reason, an inter vivos QTIP trust is more protected from potential creditor's claims of a donor than a SLAT. However, if the more important objective is reduction in estate taxes and use of the Basic Exclusion Amount based upon existing exemption levels, a SLAT has greater tax benefits because gifts to SLATs are completed transfers using the donor's Basic Exclusion Amount on the date of the gift.⁷¹ Thus, gifts to SLATs are not subject to a later reduction of the Basic Exclusion Amount by future legislation or, if later, December 31, 2025 when the existing Basic Exclusion Amount is reduced by 50%.⁷²

1-6 BLENDED FAMILY ASSET PROTECTION AND ESTATE PLANNING WITH INTER VIVOS QTIP TRUSTS

Inter vivos QTIP trusts provide a safe option for those in second marriages where one spouse has modest assets to utilize the Basic Exclusion Amount of the less wealthy spouse if the spouse with greater assets is willing to provide his or her spouse with the right to income from the inter vivos QTIP trust for life regardless of future dissolution of marriage. Planning to use the Basic Exclusion Amount of the less wealthy spouse is based, in part, on whether the wealthy spouse has already used a significant part of his or her Basic Exclusion Amount. If the wealthy spouse has not made prior use of his or her Basic Exclusion Amount, the safest option for the wealthy spouse is to make a gift of his or her remaining Basic Exclusion Amount to his or her children and have the new spouse agree to file a split gift election so that 50% of the gift is deemed to come from the new spouse and is therefore protected by the new spouse's Basic Exclusion Amount.⁷³ If the wealthy spouse has not made prior taxable gifts, as much as \$22.8 Million of gifts can be made by the wealthy spouse, free of gift tax, using both spouses Basic Exclusion Amounts if the new spouse files a split gift election under Code Section 2513 for the tax year 2018. Such a plan is oftentimes acceptable for a person who is not worried about loss of access of the gifted assets and has no need to reserve an interest in such gifted assets.

Most who have significant wealth have typically already used a significant portion of their Basic Exclusion Amount. As a result, a gift of twice the Basic Exclusion Amount even with a split election will result in gift tax to the wealthier spouse not protected by his or her Basic Exclusion Amount because such prior gifts reduce the amount the wealthier spouse can gift tax free.

Example: The wealthier spouse has already made prior taxable gifts of \$5 Million. As a result of the increased Basic Exclusion Amount in 2019, the wealthier spouse could make a gift of \$6.4 Million (i.e., \$11.4 Million - \$5 Million of prior taxable gifts) without paying gift tax. If the new spouse agrees to a split gift election, a gift of \$12.8 Million can be made without payment of gift tax. However, the new spouse will still have \$5 Million of unused Basic Exclusion Amount. If, instead, the wealthier spouse made a gift of \$17.8 Million and the spouses file a split gift election, each spouse is deemed to have made a gift of \$8.9 Million. The wealthier spouse can offset \$6.4 Million of gifts with his or her remaining Basic Exclusion Amount. However, since

⁷¹ See Section 1-7 for further SLAT discussion.

⁷² See Section 1-7 for SLAT planning where SLAT assets do not return to the initial donor spouse if the donee spouse is the first to die.

⁷³ Code Section 2513. See also Diana S.C. Zeydel, *Gift-Splitting – A Boondoggle or a Bad Idea? A Comprehensive Look at the Rules*, Journal of Taxation, Jun 2007.

the wealthier spouse is deemed to have made a gift of \$8.9 Million as a result of the split gift election, the wealthier spouse would have a taxable gift of \$2.5 Million and would have to pay gift tax of \$1,000,000. The new spouse would have no tax to pay.

Another option is for the wealthier spouse to make a gift, protected by the gift tax marital deduction, to the new spouse of \$11.4 Million with the understanding (but not contractual obligation) that the new spouse will make a substantial “re-gift” of such funds to the wealthier spouse’s family and the new spouse would use his or her Basic Exclusion Amount to shelter all gift tax. This plan is dangerous because the new spouse could decide to keep the entire \$11.4 Million. If there was a contract or other agreement that the new spouse will immediately re-gift or endorse the check to the wealthier spouse’s true desired beneficiaries, the gift to the new spouse would likely be disregarded in the event of an audit and the transaction would be treated as a direct gift by the wealthier spouse to the wealthier spouse’s intended beneficiaries, excluding the new spouse.

An alternative to an outright gift to a spouse that is intended to be re-gifted in whole or in part, is a gift by the wealthy spouse to an inter vivos QTIP trust with a back end (i.e., a retained interest in the trust upon the death of the new spouse) retained interest in favor of the wealthier spouse to a trust that could qualify for the estate tax marital deduction upon the death of the new spouse. If the wealthier spouse predeceases the new spouse, the inter vivos QTIP trust could provide that any remaining assets pass to the lineal descendants of the wealthier spouse.⁷⁴ Such planning creates a lifetime benefit for the new spouse, in the form of annual distributions of a minimum of all trust income, payable no less frequently than annually, which benefit must continue in the event of dissolution of marriage to qualify for the gift tax marital deduction. The goal is for the wealthier spouse to make a completed gift to an inter vivos QTIP trust held for the new spouse so that the gift qualified for the gift tax marital deduction and would use the Basic Exclusion Amount of the new spouse upon the death of the new spouse so such assets can pass free of estate and generation-skipping transfer taxes to the lineal descendants of the wealthier spouse.

If the wealthier spouse prefers to make a large current gift to his or her children sheltered by the new spouse’s Basic Exclusion Amount, the inter vivos QTIP trust can be drafted so if there is either a qualified or unqualified disclaimer by the new spouse the assets will pass to the wealthier spouse’s children or more remote descendants. This plan takes away the possibility that the new spouse can keep \$11.4 Million that could be gifted by the wealthier spouse outright to the new spouse with an understanding that a substantial portion will be re-gifted to the children or more remote lineal descendants of the wealthier spouse. With an inter vivos QTIP trust plan, even if the new spouse does not follow the plan, all that the new spouse retains is an income interest in the QTIP trust for the rest of his or her life. Even if the inter vivos QTIP trust is funded with \$11.4 Million and annual income is 3%, approximately \$342,000 per year will be paid to the new spouse for rest of his or her life. The tax savings if the new spouse renounces by a non-qualified disclaimer the entire trust in favor of the wealthier spouse’s children and more remote descendants is over \$4.56 Million (i.e., 40% of \$11.4 Million). Notwithstanding the risk that the new spouse may decide not to renounce his or her trust interest so he or she can enjoy the inter vivos QTIP trust assets for the remainder of his or her life, a wealthier spouse may be willing to take the risk and use an inter vivos QTIP trust plan with the new spouse to potentially save \$4.56 Million in gift and/or estate tax and provide an immediate benefit to the wealthier spouse’s children and/or more remote descendants if the new spouse cooperates with the proposed plan.

As described in Section 1-1, above, there are also income tax risks to the wealthier spouse who creates an inter vivos QTIP trust upon dissolution of marriage. As a result of repeal of Code Section 682 it is possible that the wealthy spouse will be obligated to pay income tax on the inter vivos QTIP trust income regardless of whether the wealthy spouse and the new spouse have dissolved their marriage. The tax obligation as well as the consequence of dissolution of marriage where the new spouse will continue to receive income from the inter vivos QTIP trust for the rest of his or her life can be addressed in a Postnuptial Agreement. Such Postnuptial Agreement can provide that the new spouse agrees any income the new spouse receives from the inter vivos QTIP trust, net of income taxes, reduces any obligation the wealthy spouse would otherwise have to pay to the new spouse. In addition, the Postnuptial Agreement can require the new spouse to reimburse the wealthy spouse for income taxes payable by the wealthy spouse attributable to income paid to the new spouse from the inter vivos QTIP trust after dissolution of marriage. The new spouse is likely to negotiate for some consideration for the use of the new spouse’s Basic Exclusion Amount as a result of the deemed gift made by the new spouse upon renouncing the interest of the new spouse in the inter vivos QTIP trust in a non-qualified disclaimer (e.g., a renunciation of the trust by the new spouse more than 9

⁷⁴ Richard S. Franklin, *Lifetime QTIPs: Why Should They Be Ubiquitous in Estate Planning?*, 50th Heckerling Institute on Estate Planning, available at: https://www.americanbar.org/content/dam/aba/events/real_property_trust_estate/heckerling/2016/heckerling_report_2016_report_07.authcheckdam.pdf.

months after the transfer of assets to such trust). A qualified disclaimer is not an effective way to use the new spouse's Basic Exclusion Amount because the wealthy spouse would be deemed to have made a gift directly to the remainder beneficiaries (the lineal descendants of the wealthy spouse) of the inter vivos QTIP trust in the event of a qualified disclaimer by the new spouse.

If a renunciation is made of the new spouse's interest in the inter vivos QTIP trust that is not a qualified disclaimer under Code Section 2518, the new spouse is deemed to have made a gift of the trust assets under Code Sections 2519 and 2511 (as to trust income). The result is the same if the new spouse makes a non-qualified disclaimer of all or a portion of the inter vivos QTIP trust so care must be taken using this technique to avoid an unexpected gift to the new spouse of the entire trust even if only a portion of such trust is renounced.⁷⁵ It may be possible to first divide the inter vivos QTIP trust into two shares and then have the donee spouse make a non-qualified disclaimer over only one trust.⁷⁶

To ensure a non-qualified disclaimer, the new spouse could renounce his or her interest after he or she "accepted the benefits" of the trust income from the inter vivos QTIP trust so a qualified disclaimer under Code Section 2518 is not permitted. The intent is for the new spouse to make a taxable gift under Code Section 2519 as a result of the renunciation. It is unclear whether the inter vivos QTIP trust can provide that if the new spouse renounces, inter vivos QTIP trust assets pass to a trust for the wealthier spouse, retain asset protection, and avoid estate tax exclusion for the wealthier spouse. Assuming the assets revert to the wealthy spouse as a result of the new spouse's renunciation and no inter vivos QTIP election is made for the backend interest, it is critical to consider whether the renunciation will result in the same asset protection benefits in favor of the wealthier spouse that would have existed had the new spouse predeceased the wealthier spouse (rather than renounced his or her interest). Although such planning may work in a domestic asset protection trust jurisdiction, it does not appear that such planning is contemplated by Florida Statutes 736.0505(3)(b), which states that such a backend interest "shall, **after the death** of the settlor's spouse, be deemed to have been contributed by the settlor's spouse, and not the settlor." Of the seventeen (17) inter vivos QTIP trust states, only Arizona, Maryland, and Michigan provide asset protection in the event the initial donee spouse's interest terminates for reasons other than death (e.g., as a result of renunciation). Michigan's statute refers to the termination of the individual's spouse's prior beneficial interest in the trust.⁷⁷ Whether intentional or not, Michigan's statute is likely to protect reversions back to the initial donor while the initial donee spouse is living. In addition, Maryland's statute provides that an individual who creates a trust may not be considered the settlor/donor of that trust with regard to the individual's interest in the trust if: (i) the individual creates or has created a trust for the benefit of the individual's spouse; (ii) the trust is treated as qualified terminable interest property under Code Section 2523(f); and (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.⁷⁸

When the anticipated reversion will result from renunciation of the donee's interest while living, it may be safer to create an inter vivos QTIP trust with a backend reversion in favor of the wealthier spouse in a self-settled asset protection state or Inter Vivos QTIP Jurisdiction such as Arizona, Maryland, and Michigan. If creditors can reach the backend interest with a renunciation of an inter vivos QTIP the consequence is both loss of creditor protection and potential inclusion of the trust assets in the gross estate of the initial donor (the wealthier spouse) thereby wasting the Basic Exclusion Amount of the new spouse. The stakes are high! The law is not settled.⁷⁹

1-7 CAN A SLAT PROVIDE BETTER OVERALL RESULTS?

As discussed herein, SLATs are trusts "where one spouse (the initial 'donor spouse') makes a gift to an irrevocable trust for the other (the 'initial donee spouse'), and when the initial donee spouse dies, the assets typically pass on for children and grandchildren."⁸⁰ However, SLATs are often created where assets pass back in trust for the initial donor spouse upon the death of the initial donee spouse.

⁷⁵ For a more comprehensive analysis, see Richard S. Franklin, *Lifetime QTIPs: Why Should They Be Ubiquitous in Estate Planning?*, 50th Heckerling Institute on Estate Planning, available at: https://www.americanbar.org/content/dam/aba/events/real_property_trust_estate/heckerling/2016/heckerling_report_2016_report_07.authcheckdam.pdf.

⁷⁶ See Private Letter Ruling 200530014.

⁷⁷ Mich. Comp. Laws Section 700.7506(4).

⁷⁸ Md. Est. & Tr. Code Ann. Section 14.5-1003(a)(1)-(2).

⁷⁹ See Chapter 10 for a discussion on domestic asset protection trusts.

⁸⁰ Andrew M. Katzenstein and Anat Simantob, *Painless Giving Techniques that Achieve Transfer Tax Savings*, Estate Planning Journal (Jul 2013).

Inter vivos QTIP trust planning has limitations compared to similar plans that use a SLAT because inter vivos QTIP trusts do not freeze values of its assets for estate tax purposes. The advantage of the SLAT is that post gift appreciation is removed from future estate and generation-skipping transfer taxes. However, the disadvantages of SLATs as compared to inter vivos QTIP trusts include the following: (i) assets conveyed to a SLAT do not benefit from a step up in income tax basis upon the death of the primary beneficiary of the SLAT and (ii) distributions upon the death of the initial SLAT beneficiary back to the initial donor spouse are not protected by Florida Statute Section 736.0505(3) and similar statutes of most inter vivos QTIP trust jurisdictions. Therefore the assets that return to the initial donor spouse (whether outright or in trust, whether based upon a reversion in the SLAT or through the exercise of a power of appointment) could be subject to the initial donor's creditors' claims under the Relation Back Doctrine and to estate taxes.⁸¹ As a result, careful analysis of estate and potential income taxes, and loss of asset protection is required when SLATs are considered.⁸² Those (i) that live in states, such as Florida, with inter vivos QTIP trust legislation and (ii) who believe it is unlikely that the aggregate taxable estates of a husband and wife will exceed their anticipated Basic Exclusion Amounts (taking into account whether the existing Basic Exclusion Amount per person may be reduced) are better off with inter vivos QTIP trusts than SLATs so that they can achieve the asset protection benefits provided by their states statute and a step up in income tax basis that results where assets are included in a decedent's estate under Code Section 2044 for inter vivos QTIP trusts but not for SLATs.

For those concerned that the Basic Exclusion Amount may be reduced by a new Congress, creating SLATs with the donor's \$11.4 million Basic Exclusion Amount and then allowing such assets to appreciate in the SLAT is a consideration, especially for those who are comfortable with SLAT assets passing to children or other desired beneficiaries other than the donor of the SLAT upon the death of the donee spouse. Gifts in 2018 to a SLAT using a donor's remaining Basic Exclusion Amount ensures that the growth on any assets remaining in the SLAT will pass free of Death Tax if upon the death of the initial donee spouse SLAT assets pass to beneficiaries other than the donor of the SLAT, even if the Basic Exclusion Amount is reduced by a future Congress. An important consideration with using an inter vivos QTIP trust compared to a SLAT is that most inter vivos QTIP trust jurisdictions, including Florida, require that a gift tax QTIP election be made to obtain the asset protection benefit (that the initial donee spouse is considered the settlor of the trust created for the initial donor spouse) upon the death of the initial donee spouse.⁸³ As a result, if the plan is for SLAT assets to return in trust for the surviving donor spouse who created the SLAT, there is a possibility such assets will be subject to estate tax inclusion of the initial donor spouse of the SLAT under Code Sections 2036 or 2041, and to the claims of creditors of such donor spouse upon the death of the initial donee spouse based upon the Relation Back Doctrine.⁸⁴ While Treas. Reg. Section 25.2523(f)-1(f), Example 11, provides that assets held in an inter vivos QTIP trust — for the benefit of the settlor after the death of his or her spouse — will not be includible in the settlor's taxable estate under Code Sections 2036 and 2038, no similar regulation exists for a SLAT.

It would appear that the favorable estate tax treatment is provided by said Treas. Reg. Section 25.2523(f)-1(f) based upon the fact that such assets are includible in the estate of the donee spouse under Code Section 2044 for an inter vivos QTIP trust upon the death of the donee spouse. The Code Section 2044 inclusion does not apply to SLATs. Providing the initial donee of a SLAT a non-general power of appointment to direct the SLAT assets back to the initial donor, as compared to retaining a reversion in the SLAT in favor of the donor, may not protect assets passing back to the initial donor spouse based upon the Relation Back Doctrine described above.⁸⁵ Although providing the initial donee of the SLAT with the non-general power of appointment and including the SLAT donor among the class that can benefit from the exercise of the power should not in and of itself cause the SLAT assets to be included in the donor's estate (e.g. assuming the power is exercised in favor of children and not the initial SLAT donor), the exercise of the power by the donee spouse in favor of the donor spouse, even in a Credit Shelter Trust, could result in such assets being subject to the initial donor's creditors in states with inter vivos QTIP trust statutes similar to Florida because such statutes require a QTIP election when the original gift is made. In such event such assets are

⁸¹ See Section 1-5 for a discussion on the Relation Back Doctrine and discussion in Chapter 10 on whether a resident of one state will benefit from the laws of a domestic asset protection state. It is unclear whether a similar argument can be made where both the donor's domicile state and the state where the inter vivos QTIP trust was created are inter vivos QTIP trust jurisdictions but the domicile state protects assets passing before the death of the donee spouse back to the donor spouse.

⁸² See Exhibit 1 Barry A. Nelson and Cassandra S. Nelson, *6 Question 2018 Gift Suitability Analysis* and Exhibit 24.

⁸³ See Ariz. Rev. Stat. Ann. § 14-10505(E); Ark. Code Ann. § 28-73-505(c); Del. Code Ann. Tit. 12 § 3536(c); Fla. Stat. § 736.0505(3); Ky. Rev. Stat. Ann. § 386B.5-020(8)(a); Md. Code Ann. Est. & Tr. § 14.5-1003(a)(1)-(2); Mich. Comp. Laws § 700.7506(4); N.C.GEN. STAT. § 36C-5-505(C); Ohio Revised Code § 5805.06(B)(3); Or. Rev. Stat. § 130.315(4); S.C. Code Ann. § 62-7-505(b)(2); Tenn. Code Ann. § 35-15-505(d); Tex. Prop. Code Ann. § 112.035(g); Va. Code Ann. §64.2-747.B(2); Wisc. Stat. Ann. § 701.0505(2)(e); Wyo. Stat. Ann. § 4-10-506(f).

⁸⁴ See Section 1-5 for a discussion on the Relation Back Doctrine.

⁸⁵ *Id.*

likely to be included in the estate of the initial donor under Code Section 2041 because the creditors of the initial donor could reach such assets held in the Credit Shelter Trust for the initial SLAT donor.⁸⁶

Some have suggested the creation of the SLAT in a jurisdiction that recognizes and protects self-settled asset protection trusts as an option to avoid asset protection concerns as to assets returning to the initial donor through a Credit Shelter Trust upon the death of the initial donee spouse.⁸⁷ The IRS has ruled favorably in a non-precedential Private Letter Ruling (“PLR”) for a trust created under Alaska law.⁸⁸ A thorough analysis of this issue is beyond the scope of these materials. However, creation of a SLAT, in one of the seventeen (17) states that have enacted self-settled asset protection trusts,⁸⁹ does not assure that trust assets will be excluded from the initial donor’s gross estate if they are appointed back to the initial donor, especially if there was an implied agreement that the assets would revert to the donor and there is a pattern of distributions to the donor where the donor lives in a state, like Florida, that has not enacted broad self-settled asset protection legislation. For example PLR 2009440002, which is frequently cited as support that the creation of an irrevocable trust in a self-settled asset protection jurisdiction such as Alaska is a completed gift and assets will not be included in the donor’s (referred to in the PLR as the “grantor”) gross estate says:

We are specifically not ruling on whether Trustee’s discretion to distribute income and principal of Trust to Grantor combined with other facts (such as, but not limited to, an understanding or pre-existing arrangement between Grantor and trustee regarding the exercise of this discretion) may cause inclusion of Trust’s assets in Grantor’s gross estate for federal estate tax purposes under Section 2036.⁹⁰

Based upon such PLR limitations, it may be dangerous for the donor spouse to (i) be included as a potential beneficiary of a SLAT during the life of the donee spouse, especially if regular distributions are made to the donor spouse and/or (ii) to have the donee spouse exercise his or her power of appointment (included in a SLAT) in favor of the donor spouse especially if such exercise is contemporaneous with or in close proximity to execution of the SLAT. Some suggest that the SLAT donor not be included as a beneficiary when the SLAT is initially executed but allowing an independent trust protector to add the SLAT donor as a potential beneficiary in the future. Certain specific provisions regarding distributions and trustees are necessary to accomplish the tax benefits of a SLAT and to avoid Code Section 2036 inclusion.⁹¹ Specifically, so long as the donor spouse is living, the trust instrument must not require distributions to the donee spouse for support purposes (i.e., “support, health, and maintenance” or “support in his or her accustomed manner of living”). If the trust instrument mandates that trust assets be distributed to the donor’s spouse for support purposes, the entire SLAT would be included and taxed as part of the donor spouse’s estate upon his or her death under Code Section 2036. Thus, to avoid Code Section 2036 inclusion, the trustee should be restricted from making support distributions to the donee spouse while the donor spouse is living.⁹² Based upon Treas. Reg. Section 25.2523(f)-1(f), Example 11 a trust reverting to the initial donor from an inter vivos QTIP trust created for the donee spouse is protected from estate tax inclusion under Code Sections 2036 or 2038 (and further protected in states, such as Florida, that have statutes which provide that the donor’s spouse is deemed the donor when assets from an inter vivos QTIP trust pass back to the donor spouse). Accordingly, inter vivos QTIP trust assets that revert back to the initial donor are protected from creditors of the initial donor under Florida law and should not be includible in the gross estate of the initial donor spouse. The SLAT approach does not have a Treasury Regulation that says the initial donor will not be taxed under Code Sections 2036 or 2038. Further, most inter vivos

⁸⁶ Note that certain states such as Arizona do not require a QTIP election. However, see concerns discussed in Section 1-7.1.

⁸⁷ See Kevin Matz, *Gifting Opportunities Under the New Tax Law*, WealthManagement.com (March 2, 2018), available at <https://www.wealthmanagement.com/estate-planning/gifting-opportunities-under-new-tax-law>; Todd Eckler, *Charitable Gift Bunching Under the New Tax Law*, WealthManagement.com (July 30, 2018), available at <https://www.wealthmanagement.com/high-net-worth/charitable-gift-bunching-under-new-tax-law>; Carol G. Kroch et al., *Taking a Fresh Look at Lifetime Gift Planning Opportunities*, 38 EST. PLAN. 3, 14 (Sept. 2011); Jonathan G. Blattmachr, Mitchell M. Gans & Diana S.C. Zeydel, *Supercharged Credit Shelter Trusts versus Portability*, 28 Prob. & Prop. 10 (Mar./Apr. 2014).

⁸⁸ See Gideon Rothschild et al., *IRS Rules Self-Settled Alaska Trust Will Not Be In Grantor’s Estate*, 37 EST. PLAN 3, 13 (Jan. 2010).

⁸⁹ See David G. Shaftel, *Eleventh Annual ACTEC Comparison of the Domestic Asset Protection Trust Statutes*, ACTEC J. (2017), available at <https://www.actec.org/assets/1/6/Shaftel-Comparison-of-the-Domestic-Asset-Protection-Trust-Statutes.pdf>.

⁹⁰ PLR 2009440002.

⁹¹ See Andrew M. Katzenstein and Anat Simantob, *Painless Giving Techniques that Achieve Transfer Tax Savings*, Estate Planning Journal (Jul 2013). See also Mitchell Gans and Jonathan Blattmachr, *Another Look at Spousal Lifetime Access Trusts*, LISI Estate Planning Newsletter #1387 (December 18, 2008) at <http://www.leimbergservices.com>.

⁹² *Id.*

QTIP statutes (such as Florida's) specifically say that the initial donee's spouse (the initial donor spouse) is deemed to be the donor when trust assets revert in trust for the initial donor spouse only if a QTIP election was made.⁹³

The tax treatment of assets reverting back to a trust for the initial donor of a SLAT, whether by a provision in the SLAT reserving the assets upon the death of the donee spouse or through the exercise of a power of appointment by the donee spouse of the SLAT, may be subject to estate tax upon the death of the initial donor of the SLAT because both the Treasury Regulation, mentioned above, and most inter vivos QTIP trust statutes such as Florida Statute 736.0505(3) require a QTIP election. Because of asset protection and estate tax uncertainty for SLATs where assets return to the initial donor upon the death of the initial donee, the safest approach when it comes to asset protection and estate tax avoidance is to create an inter vivos QTIP trust in a state, such as Florida, if the desire is that upon the death of the initial donee spouse, the gifted assets will continue in trust for the benefit of the initial donor, provided the donor is aware there will be no assurance that the current Basic Exclusion Amount will be available because inter vivos QTIP trusts do not use the Basic Exclusion Amount or freeze the value of gifts.

As an alternative, residents of inter vivos QTIP trust states, such as Florida, can use of a combination of an inter vivos QTIP trust created by one spouse and a SLAT created by another spouse where the QTIP assets will revert in trust for to the initial donor spouse upon the death of the initial donee spouse and the assets of the SLAT pass to children (and not in trust for the initial donor spouse) upon the death of the initial donee spouse. Life insurance could be purchased on the life of the initial donee spouse of the SLAT to replace assets that will pass to children upon the death of the initial donee of the SLAT. If the life insurance is owned by an irrevocable life insurance trust and provides discretionary distributions of income or principal to the surviving spouse of the original SLAT donee, the life insurance proceeds should be protected from creditors of the surviving spouse because the gift to the surviving spouse did not come from the SLAT. Alternatively, the life insurance can be owned directly by the initial donee spouse and upon the death of such spouse the life insurance proceeds can be paid to a testamentary QTIP trust created for the benefit of the donor spouse of the SLAT. However, unlike assets passing in trust for a surviving spouse from a well drafted life insurance trust that will not be included in the gross estate of the surviving spouse for estate tax purposes, if a QTIP election is made for a life insurance policy that is owned by the insured spouse and paid to a QTIP trust for the surviving spouse, such life insurance proceeds will be included in the gross estate of the surviving spouse under Code Section 2044.

1-7.1 Having Your Cake and Eating It Too

Arizona, Maryland, and Michigan provide asset protection of inter vivos QTIP trusts and may also protect use of current Basic Exclusion Amounts.⁹⁴ As discussed in this Section 1-7, above, statutes such as Florida Statute Section 736.0505(3) provide maximum asset protection for assets that return upon the death of the initial donee spouse to the initial donor of an inter vivos QTIP trust where an election is made under Code Section 2523(f). However, SLATs are not as protected because no Code Section 2523(f) election can be made for a SLAT. Inter vivos QTIP trusts do not result in a freeze of estate tax values using the existing Basic Exclusion Amount but SLATs do. Is there planning that provides the best of SLATs and inter vivos QTIP trusts?

Maryland's inter vivos QTIP trust statute is similar to Florida's but unlike Florida, which provides that assets passing back to a trust for the initial donor are deemed to be created by the initial donee spouse upon **the death** of the initial donee spouse, Maryland provides that such status results upon **termination** (not limited to death) of the initial donee spouse's interest. Accordingly, an effective plan using Maryland law would be for one spouse (Dennis) to create an inter vivos QTIP trust for his spouse (Debbie) and make an election under Code Section 2523(f). After Debbie accepts the benefits of the inter vivos QTIP trust, and if possible, more than 9 months after the QTIP gift, Debbie renounces her interest in the inter vivos QTIP trust. The inter vivos QTIP trust can provide that upon Debbie's death or renunciation assets pass to a Credit Shelter trust for Dennis. The renunciation by Debbie creates a taxable gift of the principal of the inter vivos QTIP trust under Code Section 2519 and a gift of the income interest of the inter vivos QTIP trust under Code Section 2511. Consequently, the renunciation by Debbie as a result of a non-qualified disclaimer/renunciation will result in using Debbie's Basic Exclusion Amount under current law. Although Regulation 25.2523(f)-1(f), Example 11 refers to the death of the inter vivos QTIP trust beneficiary, it would appear that subjecting such trust assets to gift tax under Code Sections 2519 and 2511 upon the renunciation by Debbie is very similar to the Code Section 2044 inclusion upon the death of the beneficiary

⁹³ Fla. Stat. § 736.0505(3)(a).

⁹⁴ Ariz. Rev. Stat. 14-10505(E)1-4; Md. Est. & Tr. Code Ann. 14.5 – 1003(a)(1)-(2); and Mich. Comp. Laws 700.7506(4).

of an inter vivos QTIP trust. However, the IRS could take a contrary position because Regulation 25.2523(f)-1(f) applies only after the death (not renunciation) of the initial donee spouse.

Until states like Florida revise their inter vivos QTIP trust legislation to be similar to Arizona, Maryland, and Michigan, the asset protection and estate tax savings benefits of SLATs are questionable where assets pass to the initial donor in a credit shelter trust upon the death of the inter vivos QTIP trust donee.⁹⁵ Because of the uncertainty in the application of another state's law, it would be beneficial for inter vivos QTIP trust jurisdictions to follow the example of Arizona, Maryland, and Michigan to assure the favorable estate tax and asset protection benefits described herein. See Exhibit 10 for an example of a simple change that could be made to Florida Statute Section 736.0505(3) so it is clear that a non-qualified disclaimer that results in inter vivos QTIP trust assets passing to a Credit Shelter Trust will be protected from the creditors of the initial donor spouse. See Exhibit 11 for a comparison of inter vivos QTIP trust statutes.⁹⁶

1-7.2 Inter Vivos QTIP Trusts for Those With Reduced Life Expectancy and Those Who are Terminally Ill

Where one married spouse has a limited life expectancy, use of an inter vivos QTIP trust can provide an opportunity to shift assets from the healthy spouse to the ill spouse with a reversion to a Credit Shelter Trust upon the death of the ill spouse that will be asset protected from creditors of the healthy spouse. This planning is especially favorable where the ill spouse does not have significant assets or where most assets are jointly owned and otherwise would pass outright to the surviving spouse by operation of law. Upon the death of the ill spouse, the assets returning in trust for the initial donor spouse are protected under Code Section 736.0505(3). If the donee spouse survives one year from the date of transfer of assets to the inter vivos QTIP trust, Code Section 2014(e) will also allow for a step-up in income tax basis upon the death of the initial donee spouse.⁹⁷

1-8 BENEFITS OF SUPERCHARGINGsm AN INTER VIVOS QTIP TRUST OR SLAT

The term “supercharging” refers to income of an inter vivos QTIP trust or a SLAT that is taxed as a grantor trust whether or not distributions are made from the trust. Upon creation of an inter vivos QTIP trust or a SLAT, the trust is created as a grantor trust with respect to the donor spouse (assuming the donee spouse is a beneficiary with respect to both trust income and principal).⁹⁸ If the donee spouse receives income only, the trust is a grantor trust only as to income unless the donor reserves powers such as a reversion or a right to substitute assets in exchange for other trust assets of equal value or a reversion of assets upon the death of the donee spouse.⁹⁹ Following the initial donee spouse's death, the assets in a inter vivos QTIP trust are includible in the donee spouse's gross estate.¹⁰⁰ Estate tax is avoided to the extent of the donee spouse's remaining Basic Exclusion Amount. The inter vivos QTIP

⁹⁵ See Chapter 10 for a discussion on whether trusts can be created in states that have more favorable asset protection provisions and whether the laws of such states will be respected if a contrary public policy exists in the donor's domicile state.

⁹⁶ See Barry A. Nelson, Chapter 17: *Asset Protection & Estate Planning – Why Not Have Both?*, The Forty-Sixth Annual Heckerling Institute on Estate Planning (2012) at 1701.2[D] for a discussion of how Arizona, Kentucky, North Carolina, Tennessee, and Texas have enacted statutes that are broader than typical inter vivos QTIP statutes and do not require a QTIP election under Code Section 2523(f) as a condition for treating assets passing back to the original donor upon the death of the donor's spouse as created by the donor's spouse and not the donor. In that article, the author concludes: “While at first glance the Arizona, Kentucky, North Carolina, Tennessee and Texas statutes appear to create great asset protection and the possibility of enhanced estate tax benefits that are afforded to credit shelter trusts as compared to an inter vivos QTIP Trusts (i.e., all appreciation of assets in the credit shelter trust would avoid future estate taxes and regardless of whether the applicable exclusion amount is reduced the assets in a credit shelter trust should not be subject to estate tax inclusion), there are two potential pitfalls to the Arizona, Kentucky, North Carolina and Texas statutes: (1) the trust needs to have their situs in Arizona, Kentucky, North Carolina, Tennessee and/or Texas and be subject to income tax there; and (2) there is no provision similar to IRS Treas. Reg. § 25.2523(f)-1(f), Example 11 that assures that the initial donor will not be subject to tax under §§ 2036 or 2038 of the Internal Revenue Code. As a result, the IRS could take the position that despite state law, the initial donor has an interest under §§ 2036 and 2038 of the Internal Revenue Code, resulting in estate tax inclusion.” Further, as discussed in Chapter 10, Section 10-4, it is unclear whether a resident of a state that does not extend inter vivos QTIP trust protection unless a QTIP election was made will benefit from the law of another state.

⁹⁷ See Richard S. Franklin and George D. Karibjanian, *An Oxymoron? The Deathbed Lifetime QTIP for Basis Adjustment and Asset Protection*, Bloomberg BNA Tax Management Estates, Gifts and Trusts Journal (2016). Reproduced with permission from Tax Management Estates, Gifts, and Trusts Journal, Vol. 41, No. 6, p. 219, 11/10/2016.

⁹⁸ Jonathan G. Blattmachr, Mitchell M. Gans & Diana S.C. Zeydel, *Supercharged Credit Shelter Trusts versus Portability*, 28 Prob. & Prop. 10 (Mar./Apr. 2014). See I.R.C. §§ 676, 677, 2523(i).

⁹⁹ I.R.C. §§ 674, 677.

¹⁰⁰ I.R.C. § 2044.

trust can be drafted to either: (i) provide that if the initial donor spouse survives the initial donee spouse, assets are held in trust for the initial donor spouse; or (ii) provide the initial donee spouse with a non-general power of appointment that can be exercised by the initial donee spouse in favor of the initial donor spouse and lineal descendants.

For income tax purposes, the trust created upon the death of the initial donee spouse for the initial donor spouse whether from an inter vivos QTIP trust or a SLAT can continue to be treated as the donor spouse's grantor trust after the donee spouse's death, provided the trustee has discretion to make distributions of income and principal to the initial donor spouse.¹⁰¹ The trust's taxable income will continue to be attributed to the donor spouse under the grantor trust rules by reason of the donor spouse's discretionary interest in trust income and principal or if the donor spouse continues to have a power to substitute assets of equal value in return for assets of the trust held for the donor spouse.¹⁰² The initial donor spouse is viewed as the grantor of the trust for income tax purposes, and his or her payment of the tax on the trust's income does not constitute a taxable gift.¹⁰³

When the asset protection and "supercharged" gift tax benefits of inter vivos QTIP trust or SLAT planning are combined, both asset protection and Death Tax reduction are maximized.¹⁰⁴

1-9 FACTORS TO CONSIDER WHEN EVALUATING AN INTER VIVOS QTIP TRUST OR A SLAT

1-9.1 Net Worth

Clients who are domiciled in inter vivos QTIP trust jurisdictions, such as Florida, will appreciate the certain tax and asset protection results of creating inter vivos QTIP trusts in their home state. Prior to portability and the increase of the Basic Exclusion Amount to \$11.4 Million, many estate plans included Credit Shelter Trusts to ensure the Basic Exclusion Amounts of each spouse was used since the surviving spouse was not able to use any unused Basic Exclusion Amount of the first spouse to die. Another benefit of a Credit Shelter Trust was that assets held in such trust are not included in the gross estate of the surviving spouse and avoided a 40% estate tax on Credit Shelter Trust appreciation. However, to the extent assets are left to a surviving spouse in a Credit Shelter Trust, such assets will not benefit from a step up in income tax basis to fair market value upon the death of the surviving spouse as would occur if the assets in the Credit Shelter Trust were instead owned outright by the surviving spouse or through a QTIP trust. Due to the benefit of obtaining a step up in income tax basis upon the death of the surviving spouse, the Credit Shelter Trust may no longer be beneficial for the vast majority of clients who anticipate having no estate tax upon the death of the surviving spouse, even taking into account appreciation of assets held by or for the benefit of the surviving spouse in light of the \$22.8 million Applicable Exclusion Amount available to the surviving spouse (assuming the first spouse to die did not use any portion of his or her Basic Exclusion Amount and portability under law as of the date of death of the surviving spouse remains available to the surviving spouse).

For wealthier clients, creating a SLAT for a spouse could provide significant estate tax benefits because the assets held in a SLAT (including appreciation) will not be subject to estate and generation-skipping transfer taxes upon the death of the donee spouse, whereas the inter vivos QTIP trust assets are subject to estate and generation-skipping transfer taxes upon the death of the donee spouse based upon date of death values. If the inter vivos QTIP trust assets, when combined with the other assets of the donee spouse passing to the donor spouse, exceed the surviving spouse's Basic Exclusion Amount for the year of death, additional estate taxes will be incurred. Wealthier clients may be willing to create inter vivos or testamentary trusts for their children with their \$11.4 million Basic Exclusion Amount (or such lesser amount based upon prior taxable gifts) excluding their spouse as a beneficiary based upon the assumption that their spouse has significant assets of their own to use during their lifetime. Alternatively, couples who are not willing to lose the ability to benefit from \$11.4 million Basic Exclusion Amount upon the death of the first spouse and are not concerned about assets passing to children or other beneficiaries upon the death of the first spouse may consider the creation of one SLAT that could benefit the donee spouse during his or her lifetime (at the

¹⁰¹ Jonathan G. Blattmachr, Mitchell M. Gans & Diana S.C. Zeydel, *Supercharged Credit Shelter Trusts versus Portability*, 28 Prob. & Prop. 10 (Mar./Apr. 2014).

¹⁰² I.R.C. §§ 676, 677.

¹⁰³ See Treas. Reg. § 1.671-2(e)(5).

¹⁰⁴ See Jonathan G. Blattmachr, Mitchell M. Gans & Diana S.C. Zeydel, *Supercharged Credit Shelter Trusts versus Portability*, 28 Prob. & Prop. 10 (Mar./Apr. 2014).

discretion of the trustee) and allow for invasions for the spouse, children, and grandchildren, and one inter vivos QTIP trust. The SLAT assets can pass to children or grandchildren (and not the SLAT's donor) upon the death of the donee spouse. The donee spouse of the SLAT can create an inter vivos QTIP trust for the other spouse, and reserve a remainder interest in the inter vivos QTIP trust upon the death of the initial beneficiary thereof. Before proceeding, a review of income tax basis issues is important (described in Section 1-1, above). Another option is for the SLAT to designate an independent trust protector who is authorized to include the donor's spouse as a potential beneficiary of a SLAT after it is created. Such an approach allows the couple and the trust protector to consider tax laws and net worth as time passes and to evaluate whether the addition of the initial trust donor is beneficial.¹⁰⁵

1-9.2 Jurisdiction

Based upon potential challenges for those who create self-settled asset protection trusts outside of their state of domicile, the safest approach for Florida residents and for those of different states who are married, do not have self-settled asset protection legislation but have inter vivos QTIP trust legislation, and have asset protection concerns is to create an inter vivos QTIP trust under Florida or other similar applicable law.¹⁰⁶

1-9.3 Possibility that the Basic Exclusion Amount Will be Reduced

In order for clients to decide whether to make use of their Basic Exclusion Amount while living they should consider, among other things, the possibility of a reduced Basic Exclusion Amount. The Basic Exclusion Amount was doubled as part of the 2017 Tax Act and as of the date of this publication is set to be reduced to its prior level (about 50% of the current Basic Exclusion Amount) on December 31, 2025, as adjusted by the CPI.

The level of the Basic Exclusion Amount is dependent, at least in part, upon which political party is in power. For example, Hillary Clinton's estate tax proposal during the 2016 presidential campaign was to reduce the Basic Exclusion Amount to \$3.5 million.¹⁰⁷ If it is likely that a person's gross estate will be less than the \$11.4 million Basic Exclusion Amount (\$22.8 million in the aggregate for spouses), retaining high value appreciated assets until death is most tax efficient in order to obtain a step up in income tax basis at death. If, however, the Basic Exclusion Amount is not expected to be sufficient to avoid estate tax then SLAT or Credit Shelter Trust planning may result in minimizing the amount of assets that will ultimately be subject to the 40% estate tax notwithstanding the loss of step up in income tax basis for assets in a SLAT or Credit Shelter Trust that are not included in the gross estate of the surviving spouse. As noted in "Additional Factors" described in Section 1-1, above, and Sections 1-8.5 through 1-8.9, below, there are multiple considerations as to whether it is currently tax efficient to make gifts in light of the existing Basic Exclusion Amount based upon the possibility that the Basic Exclusion Amount could be reduced by future legislation.

The same issues discussed in the Gift Suitability Analysis, attached as Exhibit 1, apply in determining whether to use a Credit Shelter Trust upon the death of the first spouse. A trust protector can be empowered to change a non-general power of appointment in a Credit Shelter Trust to a general power of appointment upon the death of the surviving spouse if the trust protector believes the creation of the general power of appointment would reduce overall estate and income tax exposure based upon the facts that existed prior to the surviving spouse's death. Such planning would be effective to obtain a step up in income tax basis for assets subject to estate tax inclusion as a result of the trust protector's creation of a general power of appointment, provided the inclusion of such assets in the decedent's estate will be sheltered by the Applicable Exclusion Amount of the surviving spouse. However, each of these options creates significant non-tax issues, especially where spouses each have children from prior marriages. In such event, providing

¹⁰⁵ See Andrew M. Katzenstein and Anat Simantob, *Painless Giving Techniques that Achieve Transfer Tax Savings*, Estate Planning Journal (Jul 2013).

¹⁰⁶ See Section 10-2.2 for a discussion on *Waldron v. Huber (In re Huber)*, BK.W.D.Wa Adversary No. 12-04171, Bankruptcy No. 11-41013, Order Granting Trustee Partial Summary Judgment, Doc. 142, May 17, 2013 (the "Order") and *In re Mortensen*, A09-00565-DMD, 14 (Bankr. D. Alaska May 26, 2011) (citing 5 Collier on Bankruptcy ¶ 548.10[1], [3][a] n.6 (N. Alan Resnick & Henry J. Sommer eds., 16th ed.)).

¹⁰⁷ Kyle Pomerleau and Michael Schuyler, *Details and Analysis of Hillary Clinton's Tax Proposal*, Tax Foundation (Jan. 26, 2016) available at <https://taxfoundation.org/details-and-analysis-hillary-clinton-s-tax-proposals/>.

a trust protector with the power to expand a power of appointment in favor of a surviving spouse could be limited to creditors of the surviving spouse and limited so any such exercise is personal to the surviving spouse. In addition, the trust protector can require the surviving spouse to obtain the consent of the trust protector as a condition of the exercise of such general power of appointment.¹⁰⁸

1-9.4 Reciprocal Trusts

If both spouses decide to create inter vivos QTIP trusts or SLATs or a combination thereof for the other, caution is required to avoid an IRS position that the trusts are reciprocal so as to treat each trust as a self-settled trust that is likely to result in the loss of asset protection benefits under applicable state law because such laws typically protect inter vivos QTIP trusts only if an election is made under the tax law to treat such trusts as inter vivos QTIP trusts. If the IRS treats such trusts as reciprocal, a valid QTIP election cannot be made.¹⁰⁹ The IRS succeeded in attacking two similar trusts created by spouses for one another with almost identical dispositive provisions in favor of each spouse where the trusts were created 15 days from one another. If SLATs are treated as reciprocal, they are also effectively considered self-settled trusts without asset protection or tax benefits.¹¹⁰

Avoidance of reciprocal trust attacks may be accomplished by allowing a considerable amount of time lapse between the creation of the trusts by each spouse for the other, and by having materially different dispositive provisions in the trusts. For example, providing for different trustees, different beneficiaries upon the death of the donee spouse, a non-general testamentary power of appointment in favor of certain beneficiaries in each trust, or not providing a power of appointment in favor of the donee spouse at all in one of the trusts.¹¹¹ Planners should also consider drafting different types of estate planning trusts for spouses and applying different vesting options and/or distribution options. The greater the number of differentiating factors, the less likely it is that the IRS will take the position that trusts are reciprocal. An example of differences where each spouse creates an inter vivos QTIP trust is reflected, below:¹¹²

Husband	Wife
All income to spouse	All income to spouse or if not an inter vivos QTIP trust no mandating of income
Purely Discretionary Principal Distributions	Distributions of principal shall be made pursuant to an ascertainable standard
5 x 5 power in favor of spouse	None
Non-General Power of Appointment	None unless provided by trust protector
Different beneficiaries	Different beneficiaries

Arizona, Kentucky, North Carolina and Texas have addressed the reciprocal trust dilemma statutorily.¹¹³ It is not certain, however, that even in such states the IRS will accept such states' provisions to disregard reciprocal trust attacks. To date, Florida has not adopted similar protection to avoid reciprocal trust status. Planners need to review the reciprocal trust issues carefully if they intend to create similar irrevocable trusts for both spouses.

¹⁰⁸ See Alexander A. Bove, Jr., *Using the Power of Appointment to Protect Assets – More Power Than You Ever Imagined*, American College of Trust and Estate Counsel Journal, 36 ACTEC 333 (Fall 2010).

¹⁰⁹ For a thorough analysis of reciprocal trusts, see Jonathan G. Blattmachr, Mitchell M. Gans & Diana S.C. Zeydel, *Supercharged Credit Shelter Trusts versus Portability*, 28 Prob. & Prop. 10 (Mar./Apr. 2014). See also *United States v. Estate of Grace*, 395 U.S. 316 (1969); Domingo P. Such, III, Esq., Deborah V. Dunn, Esq., and Mitchell A. Meneau, Esq., *A New Era of Spousal Trust Planning: An Old Concern Arises with Reciprocal Trusts*, Bloomberg Tax (2018), available at <https://www.perkinscoie.com/images/content/1/8/v2/184614/A-New-Ear-of-Spousal-Trust-Planning-Bloomberg-Tax.pdf>.

¹¹⁰ *United States v. Estate of Grace*, 395 U.S. 316 (1969).

¹¹¹ *Id.*

¹¹² See Mark Merric, *Attempting to Draft Around the Substantially Identical Factor of Reciprocal Trusts, The Doctrine of Reciprocal Trusts – Part IV*, LISI Estate Planning Newsletter #1332 (Aug. 13. 2008).

¹¹³ Arizona Revised Statutes § 14-10505(E)(4), Kentucky Revised Statutes Annotated § 386B.5-020(8)(a)(3), North Carolina General Statutes § 36C-5-505(c)(3) and Texas Property Code § 112.035(g)(3)(A).

1-9.5 Likelihood of Creditors' Claims While Married or Upon Death of the First Spouse

If there is some likelihood or concern of current or future creditors' claims, any gift to a spouse who may be subject to creditors' claims should be made into a protected trust rather than outright. If as of the time of planning neither spouse has existing or contingent creditors' claims, each spouse can create an inter vivos QTIP trust and/or a SLAT for the other spouse as long as such trusts are not considered reciprocal and transfers thereto are not considered fraudulent.¹¹⁴ If a donor spouse wants to retain access to gifts made upon the death of the donee spouse and benefit from asset protection, inter vivos QTIP trust jurisdictions, such as Florida, provide the ability for the initial donor spouse to retain a remainder interest in an inter vivos QTIP trust (but no such protection exists for SLATs) created for his or her spouse, upon the death of the initial donee spouse.¹¹⁵ If, however, an actual or contingent claim is in existence against one spouse, then that spouse cannot make a transfer into an inter vivos QTIP trust or SLAT for his or her spouse if the gift would render the donor insolvent because the transfer would be attacked as a fraudulent conveyance.¹¹⁶

In the event one spouse has existing or contingent creditor's claims, any trust for such spouse should limit distributions to him or her in an effort to ensure that the spouse's creditors ability to reach such trust assets is not enhanced. For such reason, creating a SLAT for the benefit of the spouse with creditor's claims and providing broad discretion in favor of the trustee to make distributions to or for the benefit of the spouse beneficiary may be better than an inter vivos QTIP trust because of the requirement under Code Section 2523(e) that distributions of income be made no less frequently than annually to the beneficiary spouse. However, even with an inter vivos QTIP trust created for a spouse who may consider bankruptcy only 180 days of income will be at risk in the event of a bankruptcy proceeding if the inter vivos QTIP trust is property drafted and contains a spendthrift provision.¹¹⁷ The *In re Kiesewetter* opinion provides, "because there is a valid spendthrift provision protecting the future income distributions to Debtor, all future mandatory distributions to which Debtor is entitled are excluded from the bankruptcy estate pursuant to Section 541(c)(2). Pursuant to Section 541(a)(5)(A), the bankruptcy estate, however, will include any distribution that had been received prepetition by Debtor and those distributions that she was entitled to receive within 180 days of the Petition Date."¹¹⁸

1-9.6 Acceptance of Loss of Complete Control

Outright gifts to a spouse or titling assets of one spouse in the joint names of both spouses as tenants by the entirety creates significant property rights in favor of the donee spouse.¹¹⁹ Many donors want assurance that the gifted assets will return to the donor spouse upon the death of the donee spouse should the donee spouse die first. In second marriage situations, frequently the donor spouse wants to be certain that gifted assets will pass to the donor's children (or to the donor/donee's joint children) or to specified charities upon the death of the donee spouse rather than to children of the donee spouse or to the donee spouse's prior or subsequent spouse. Inter vivos QTIP trusts and SLATs provide excellent alternatives to satisfy such donor's objectives.¹²⁰ However, a drawback of creating inter vivos QTIP trusts or SLATs is loss of control.

The donee spouse may serve as sole trustee of the inter vivos QTIP trust with discretion to make distributions to themselves for health, maintenance, and support, and maintain protection from creditors, especially if a spendthrift provision is included. The problem of having the donee spouse serve as sole trustee is the potential that the donee spouse can be manipulated as he or she ages, especially where the donee spouse and the donor spouse each have children from separate marriages (assuming the children of the donor spouse are the remainder beneficiaries). Having a successor trustee or trust protector who is empowered to serve can help ensure that the anticipated estate plan will stay intact. However, the donor spouse's children typically are not appropriate co-trustees or trust protectors due to possible conflicts with their step-parent who is the beneficiary of the inter vivos QTIP trust for such beneficiary's lifetime. Thus, while inter vivos QTIP trusts have significant benefits, clients need to consider whether they are comfortable with someone who can serve as a successor trustee and/or trust protector while the donee

¹¹⁴ See Section 1-9.4, above for a discussion on reciprocal trust doctrine. See also Chapter 15 for a discussion on fraudulent conveyances.

¹¹⁵ See discussion of Florida Statute Section 736.0505(3) in Section 1-7 of this Chapter, above, and Chapter 10, Section 10-3.1.1.1.

¹¹⁶ See Chapter 15, Sections 15-1.2.2 and 15-3 for a discussion on insolvency.

¹¹⁷ *In re Kiesewetter*, Not Reported in F. Supp. 2d (2011) (2011 WL 4527365).

¹¹⁸ *Id.*

¹¹⁹ See Chapter 12 for a discussion on third party created trusts.

¹²⁰ *Id.*

spouse is living. The same issues apply for SLATs. To avoid adverse tax consequences in SLATs, the beneficiary of a SLAT should not be a trustee as SLATs typically include beneficiaries other than the spouse and are drafted to avoid estate tax inclusion for the donee spouse whereas for an inter vivos QTIP trust, the donee spouse is the sole beneficiary during his or her lifetime and such assets are taxable to the donor spouse and includible in the estate of the donee spouse under Code Section 2044.

1-9.7 Additional Costs

If the transfer is to an inter vivos QTIP trust or a SLAT, a timely gift tax return must be filed, typically by April 15th of the year following the gift unless a timely extension is filed. If the QTIP election is not made on a timely gift tax return, the gift will not qualify for the gift tax marital deduction and, as a result, the statutory protections under Florida Statute Section 736.0505(3) in the event the initial donor receives trust assets upon the death of the original trust beneficiary will be lost. The estate attorney will be paid for creation of the trust and possibly a family attorney will be paid for preparation of the Postnuptial Agreement. Best practice is for each spouse to have separate attorneys to represent their individual interests in the Postnuptial Agreement. All of these costs should be reviewed before proceeding with an inter vivos QTIP trust or SLAT plan.¹²¹

1-9.8 Income Tax Traps

During the life of the donee spouse the inter vivos QTIP trust is treated as a grantor trust so that the initial donor reports all income deductions and credits of the trust. Typically, grantor trust status is appropriate for inter vivos QTIP trusts because the trust income must be paid no less frequently to the donee spouse while living to qualify for the gift tax marital deduction.¹²² SLATs are also typically grantor trusts to the extent of the rights held by the donee spouse. As discussed in Section 1-10.3, below, the author suggests that an inter vivos QTIP trust provide the initial donor spouse with a power to substitute assets of equivalent value for assets in the inter vivos QTIP trust.¹²³ The same power should be used for a SLAT to enhance potential income tax basis planning. Both Code Section 677(a) and Code Section 675(4)(C) cause grantor trust status as to the donor while both spouses are living and married to one another. As a result of repeal of Code Section 682 by the 2017 Tax Act, the donor of SLATs and inter vivos QTIP trusts is likely to be taxed on trust income post-dissolution of marriage which was not anticipated or the law prior to the 2017 Tax Act.¹²⁴

1-10 TAXATION OF INTER VIVOS QTIP TRUSTS AND SLATS UPON DISSOLUTION OF MARRIAGE

1-10.1 General

As a result of the repeal of Code Section 682 by the 2017 Tax Act, effective January 1, 2019, the donor spouse of an inter vivos QTIP trust will generally be taxed on all trust income under the grantor trust rules provided in Code Sections 672(e) and 677(a) even after dissolution of marriage.¹²⁵ To the extent income from a SLAT without the approval or consent of any adverse party is, or in the discretion of the grantor/donor or nonadverse party or both may be distributed to the grantor/donor or the grantor/donor's spouse or held or accumulated for future distribution to the grantor/donor or the grantor/donor's spouse, the SLAT is also a grantor trust. Unlike inter vivos QTIP trusts where the spouse must continue to receive income post-dissolution of marriage to qualify for the gift tax marital deduction, SLATs can provide for termination of the interests of the donee spouse upon dissolution of marriage, and if so, grantor trust status for SLATs should end upon dissolution of marriage. Alternatively, there is no prohibition in SLATs as there is for inter vivos QTIP trusts, that the donee spouse be the only beneficiary. As a result, a SLAT could require the trustee to reimburse the donor spouse for any income taxes payable by the donor spouse under the grantor trust rules or to pay such amounts directly to the taxing authority. Such provisions cannot be included in inter vivos QTIP trusts because the beneficiary of such trust must be the sole beneficiary of all trust income during the life of the donee spouse and no person can have the power to appoint any part of the trust property to any person other than the spouse under Code Section 2523(f)(3) with reference to Code

¹²¹ See Exhibit 1 Barry A. Nelson and Cassandra S. Nelson, *6 Question 2018 Gift Suitability Analysis*.

¹²² See Code Section 672(e)(1)(A) and Code Section 677(a).

¹²³ See Code Section 675(4)(C).

¹²⁴ See Section 1-10.

¹²⁵ As discussed below, the donor is not subject to the grantor trust rules as to principal if there are no grantor trust triggers as to principal, post-divorce.

Section 2056(b)(7)(B)(ii). Attorneys and other advisors should be aware of the continuing income tax obligations when advising clients to create inter vivos QTIP trusts and SLATs. Spouses should enter Postnuptial Agreements to address the consequences of dissolution of marriage.

Such provisions should consider inter vivos QTIP trust assets and SLAT assets in the overall division of marital assets upon dissolution of marriage and should address potential continued grantor trust status as to income tax payable on trust income post-dissolution of marriage. The Postnuptial Agreement may require the donee spouse receiving the income from an inter vivos QTIP trust, post dissolution of marriage, to reimburse the donor spouse for income taxes payable attributable to such trust. The tax reimbursement issues should also be considered in Marriage Settlement Agreements. The potential continuing income tax burden on the inter vivos QTIP trust and SLAT donor spouse as a result of the repeal of Code Section 682, unless revised through a technical correction, applies to all inter vivos QTIP trusts and SLATs regardless of whether created before or after enactment of the 2017 Tax Act if the marriage is dissolved after December 31, 2018. To avoid a surprise in the event of dissolution of marriage where the donor spouse becomes taxed on trust income paid to the beneficiary spouse, the issues described in this section should be considered prior to execution of the inter vivos QTIP trust and/or SLAT.

1-10.2 Code Section 682

Prior to the 2017 Tax Act, Code Section 682 provided that upon dissolution of marriage or legal separation, “[t]here shall be included in the gross income of a wife who is divorced . . . the amount of the income of any trust which such wife is entitled to receive and which, except for this section, would be includible in the gross income of her husband, and such amount shall not, despite any other provision of this subtitle, be includible in the gross income of such husband.”

Code Section 682 protected the donor spouse in the event of dissolution of marriage or legal separation from being taxed on the amount of trust income the donee spouse was entitled to receive under the grantor trust rules of Code Section 672(e)(1)(A) and 677(a). To qualify for the gift tax marital deduction a QTIP trust requires that all income be paid to the donee spouse during his or her lifetime, regardless of dissolution of marriage. Accordingly, prior to the 2017 Tax Act, the donor of an inter vivos QTIP trust was not subject to income tax on income received by the donee spouse from the inter vivos QTIP trust post-dissolution of marriage under Code Section 682.

Prior to Code Section 682 repeal donors needed to be aware that they could be subject to income tax on post dissolution of marriage undistributed capital gains income of certain inter vivos QTIP trusts during the remaining lifetime of the former spouse notwithstanding Code Section 682. The inter vivos QTIP trust could be drafted to minimize, alter or eliminate discretionary distributions to the initial donee spouse in the event of dissolution of marriage. In such event, even if the initial donor was obligated to pay income tax on accumulated capital gains if the trust assets could revert back to the donor spouse should the donee spouse die first the donor may be willing to risk the income tax burden. As described below, there are a number of planning options to reduce the potential income tax the donor of an inter vivos QTIP trust or SLAT would have to pay post dissolution of marriage even after repeal of Code Section 682.

As of the date of this publication, the Department of Treasury and the IRS in Notice 2018-37 requested comments on whether guidance is needed regarding the application of Code Sections 672(e)(1)(A), 674(d), and 677 following a divorce or legal separation in light of repeal of Code Section 682. The American Academy of Trusts and Estates Counsel (ACTEC) submitted comments and suggested the following:

Code Section 672(e). We recommend that Treasury and the IRS address the question of whether the spousal unity rule ends upon the grantor’s divorce. We believe that the ambiguity in the current law gives Treasury and the IRS the authority to promulgate regulations clarifying the scope of § 672(e). We also believe the ambiguity should be resolved in favor of terminating the application of § 672(e) once the spousal relationship has been terminated by decree of divorce or legal separation or by the execution of a separation agreement. The spousal unity rule is presumably based on a belief that spouses form a single economic unit. When the end of the marriage separates the unit there is no longer a reason for the rule to apply.

If Treasury and the IRS conclude that they do not have the authority to prevent the application of the spousal unity rule to taxpayers who are no longer married to each other, we recommend that they issue regulations that prevent it from applying to those provisions in Subpart E that are affected by the repeal of § 682. The sections affected by repeal of § 682 are §§ 676 and 677, because these sections treat a trust as a grantor trust when distributions of trust income or principal must or may be made to the grantor's spouse. We also recommend the issuance of regulations that provide that the internal rules within §§ 674(c) and 674(d), dealing with the consequences of powers held by spouses, should override § 672(e).

In two alternative resolutions addressing repeal of Code Section 682 and elimination of Code Section 215 alimony deduction, the American Bar Association Section of Family Law Report to the House of Delegates dated August 2018 proposed Resolution 102A and suggested the ABA urge Congress to reenact Code Sections 682 and 215 as they were prior to the 2017 Tax Act and if not reinstated, that laws be enacted to respect agreements entered into prior to the effective date of the repeal of Code Sections 682 and 215, including Prenuptial Agreements, Postnuptial Agreements, trusts and similar arrangements, but only to the extent that income is not attributable to additions to the trust after the effective date the 2017 Tax Act became effective. The ABA House of Delegates adopted Resolution 102A at its August 6-7, 2018 Annual Meeting in Chicago.¹²⁶

In a separate ACTEC letter dated July 5, 2018 to the Joint Committee on Taxation, the House Ways and Means and the Senate Finance Committee ACTEC recommended that a technical amendment be made to the effective date provisions of the 2017 Tax Act providing that Code Section 682 continues to apply to the income of the trust that were irrevocable on December 22, 2017 to the extent that such income is not attributable to corpus contributed to the trust by donor after December 22, 2017.¹²⁷

1-10.3 Planning Options

1-10.3.1 How to Reduce Adverse Income Tax Consequences to Donor of an Inter Vivos QTIP Trust or SLAT in the Event of Dissolution of Marriage

Even if the parties recognize the income tax exposure to the donor spouse post-dissolution of marriage, there is no ability to provide for a tax reimbursement clause in an inter vivos QTIP trust in favor of the donor spouse, without disqualifying such trust from the gift tax marital deduction. Code Section 2523(f)(3) applies the testamentary definition of a qualifying income interest for life for an inter vivos QTIP trust by reference to Code Section 2056(b)(7)(B)(ii). The donee spouse has a qualifying income interest for life if: (i) the donee spouse is entitled to all the income¹²⁸ from the property; and (ii) no person has a power to appoint any part of the property to any person other than the surviving spouse during the life of the surviving spouse. Accordingly, a tax reimbursement provision in favor of the donor spouse cannot be included in an inter vivos QTIP trust (although such a provision could be included in a SLAT).

Some inter vivos QTIP trusts provide that in the event of dissolution of marriage, the donee beneficiary is no longer entitled to discretionary principal distributions from the inter vivos QTIP trust. This should terminate grantor trust status under Code Section 677(a)(1) based on the discretionary right to distribute principal. In such case, if there are no other triggers (such as a power to substitute assets or a reversion upon the death of the donee spouse) creating grantor trust status as to principal, the capital gains allocated to principal should be taxable to the trust post-dissolution of marriage. However, as a result of Code Section 682 repeal, the inter vivos QTIP donor will be subject to income tax post dissolution of marriage on all income paid to the donee spouse unless the marriage was dissolved before January 1, 2019.

¹²⁶ See Exhibit 4 for American Bar Association Section of Family Law Report to House of Delegates Resolution 102A addressing repeal of Code Sections 215 and 682, adopted by the ABA House of Delegates on August 6-7 at the 2018 Annual Meeting in Chicago.

¹²⁷ See Exhibit 3 for ACTEC Response to Notice 2018-27.

¹²⁸ The term "income" means fiduciary accounting income or "trust income," and not taxable income. *See* Treas. Reg. § 25.2523(f)-1(c)(2).

1-10.3.2 Require Reimbursement of Income Taxes Payable by Donor from Other Assets of Donee Spouse

Although the inter vivos QTIP trust cannot permit distributions to anyone other than the donee spouse during the life of the donee spouse, a Post-Nuptial Agreement and/or Marital Settlement Agreement can obligate the donee spouse to reimburse the donor spouse for income taxes paid on income paid from an inter vivos QTIP trust to the donee spouse post-dissolution of marriage or enable the donor spouse to set off alimony or other payments otherwise due to the donee spouse by the income taxes payable on inter vivos QTIP income paid to the donee spouse. If a SLAT causes the income tax to be charged to the donor spouse, the SLAT can provide for reimbursement to the donor spouse because a SLAT is not subject to the requirements of Code Section 2523(f). This option is especially fair where the donor spouse has no retained interest should Code Sections 677(a) and 672(e) result in grantor trust treatment subjecting the donor spouse to tax without any rights to trust remainder upon death of the donee spouse. Perhaps this reimbursement obligation would be coupled with a right in the donee spouse to require the trustee to pay him or her an amount equal to the taxes. Without such coupling, the obligation of the donee spouse to reimburse the donor spouse may be difficult to secure. Classifying the tax reimbursement obligation of the donee spouse as “alimony” could enhance the ability of the donor spouse to enforce obligations of the donee spouse to make the tax reimbursement obligation. Based upon *Berlinger v. Casselberry* (discussed in Chapter 12),¹²⁹ the donor spouse may be able to obtain a continuing garnishment against the inter vivos QTIP trust to satisfy a judgment in the form of alimony for delinquent payments of the donee spouse.

1-10.4 Dissolution of Marriage Income Tax Traps – S Corporations

If S corporation stock is to be conveyed to an inter vivos QTIP trust or a SLAT it is important to ensure that the S election will be maintained. During the lifetime of the donor of the QTIP trust or a SLAT, providing the donor with a substitution power exercisable in a non-fiduciary capacity under Code Section 675(4)(C) and Regulation Section 1.675-1(b)(4)(iii) creates a grantor trust and the donor, not the QTIP trust or SLAT, is considered the S corporation shareholder. Pursuant to Code Section 677(a), the grantor shall be 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 – (1) distributed to the grantor or the grantor’s spouse; (2) held or accumulated for future distribution to the grantor or the grantor’s spouse; or (3) applied to the payment of premiums on policies of insurance on the life of the grantor or the grantor’s spouse.¹³⁰ Grantor trust status also applies during such time that income and principal may be paid to the donee spouse without the approval or consent of any adverse party or may, in the discretion of the grantor or a nonadverse party or both, be distributed to the donor or the donor’s spouse from the inter vivos QTIP trust or SLAT. In both instances, the trust donor is treated as the owner of the QTIP trust or SLAT. Prior to repeal of Code Section 682, upon divorce or legal separation “under a decree of divorce or of separate maintenance” or under a written separation agreement, Code Section 682 provided that any distributions to the donee spouse (or ex-spouse) will be taxed to such spouse and as a result will cause the QTIP trust or SLAT to no longer be a fully grantor trust under Code Section 682(a) as to the donor spouse and action was required to be taken to be certain the QTIP trust or SLAT will remain a qualified S corporation shareholder. As noted, repeal of Code Section 682 may resolve this issue but due to uncertainty about potential technical corrections it is not clear whether the inter vivos QTIP trust or SLAT will remain a fully grantor trust post-dissolution of marriage. As a result, it is critical for those creating QTIP trusts or SLATs with S corporation stock to be aware that upon dissolution of marriage or legal separation, either the S corporation stock is removed from the trust, possibly through the exercise of a substitution power retained by the donor of the trust, or that an electing small business trust election is made by the trustee of the trust within two months and 15 days of the date of dissolution of marriage or legal separation. Although the S corporation issues can be resolved with timely planning, the concern is that during dissolution of marriage proceedings, the parties and their advisors will be unaware of the S corporation issues and a timely Electing Small Business Trust (“ESBT”) election will not be made. Estate planners should caution their clients upon creation of inter

¹²⁹ Case No. 2D12-6470 (Fla. 2d DCA Nov. 27, 2013). See also Chapter 10.

¹³⁰ 26 U.S. Code Section 677(a). Note, however, that under 26 U.S. Code Section 677(b), income of a trust shall not be considered taxable to the grantor under subsection (a) merely because such income in the discretion of another person, the trustee, or the grantor acting as trustee or co-trustee, may be applied or distributed for the support or maintenance of a beneficiary (other than the grantor’s spouse) whom the grantor is legally obligated to support or maintain, except to the extent that such income is so applied or distributed.

vivos QTIP trusts and SLATs of the S corporation consequences. Also, counsel for an S corporation asked to approve such trusts might want to suggest that an ESBT election be made while the spouses are married and S corporation shares are held in the inter vivos QTIP trust on a conditional basis so that upon dissolution of marriage the election is immediately in force.¹³¹

¹³¹ Steve Gorin, *Structuring Ownership of Privately-Owned Businesses: Tax and Estate Planning Implications* (2018), available by emailing the author at sgorin@thompsoncoburn.com. See Barry A. Nelson & Richard Franklin, Inter Vivos QTIP Trusts Could Have Unanticipated Income Tax Results to Donor Post-Divorce, Steve Leimberg's Estate Planning Email Newsletter—Archive Message # 2244 (Sep. 14, 2015) for other income tax issues and suggestions on how to plan for divorce. For more information on S corporation and other privately owned business issues see: Steven B. Gorin, "Structuring Ownership of Privately-Owned Businesses: Tax and Estate Planning Implications," over 900 pages in a fully searchable PDF available by emailing Steve at sgorin@thompsoncoburn.com. Please put "Business Structuring Materials" in the subject line, include your email and physical mailing address, and indicate whether you would like to receive the latest version quarterly through his newsletter. Steve does not charge for this service.

EXHIBIT 1

6 Question 2018 Gift Suitability Analysis

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Date: 22-Mar-18

**Subject: Barry A. Nelson & Cassandra S. Nelson - 6 Question 2018
Gift Suitability Analysis**

"As a result of the Tax Cuts and Jobs Act of 2017 (the "2017 Tax Act") 2018 provides a unique opportunity for you to make gifts using your federal estate, gift, and generation skipping transfer ("GST") tax exemption (the basic exclusion amount) of \$11.18 Million as reflected in Rev. Proc. 2018-18, issued March 2, 2018 (reduced by any prior use of such exemption).

Unless Congress takes action the increased basic exclusion amount will sunset on December 31, 2025 to \$5 Million, as adjusted by the Consumer Price Index ("CPI"). As a result, if you miss the opportunity to use the increased basic exclusion amount prior to December 31, 2025 you may lose the ability to make significant tax-free gifts. Based upon the current estate and gift tax rate of 40%, the additional estate taxes that may result from not taking advantage of the increased basic exclusion amount of \$11.18 Million before December 31, 2025 could be over \$2.236 Million, or significantly more when appreciation on the gifted assets is taken into account.

Unlike in 2012, when taxpayers had only one year to plan for the possible loss of an increased gift tax exemption of \$5 Million, there is no rush to make gifts in 2018. Although taxpayers have until December 31, 2025 to take advantage of the increased gift tax exemption, making gifts sooner rather than later will allow taxpayers to remove future appreciation of gifted assets from their estates. The following 6 Question 2018 Gift Suitability Analysis is provided to facilitate consideration of whether to make gifts in 2018 (or before January 1, 2026) using the current basic exclusion amount."

Barry A. Nelson and Cassandra S. Nelson provide **LISI** members with a 6 Question Checklist to help determine the suitability and appropriateness of making major gifts in 2018 or thereafter based upon the increase of the basic exclusion amount to \$11.18 Million. Members will find their

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commentary particularly helpful as it is written in the format of a letter to clients.

Barry A. Nelson, a Florida Bar Board Certified Tax and Wills, Trusts and Estates Attorney, is a shareholder in the North Miami Beach law firm of **Nelson & Nelson, P.A.** He practices in the areas of tax, estate planning, asset protection planning, probate, partnerships and business law. He provides counsel to high net worth individuals and families focusing on income, estate and gift tax planning, and assists business owners to most effectively pass their ownership interests from one generation to the next. As the father of a child with autism, Mr. Nelson combines his legal skills with compassion and understanding in the preparation of Special Needs Trusts for children with disabilities. Mr. Nelson is a Fellow of the American College of Trust and Estate Counsel and served as Chairman of its Asset Protection Committee from 2009 to 2012. Mr. Nelson is named in *Chambers USA: America's Leading Lawyers for Business* and *HNW Guide* as a leading estate planning attorney in Florida. Mr. Nelson has been listed in *The Best Lawyers in America* since 1995 and is a Martindale-Hubbell AV-rated attorney. Mr. Nelson was named by Best Lawyers in America as the 2015 Trusts and Estates "Lawyer of the Year" in Miami.

As the founding chairman of the Asset Preservation Committee of the Real Property, Probate and Trust Law Section of the Florida Bar from 2004-2007, Mr. Nelson introduced and coordinated a project to write a treatise authored by committee members entitled *Asset Protection in Florida* (Florida Bar CLE 2008, 5th Edition 2017). Mr. Nelson wrote Chapter 5 entitled "Homestead: Creditor Issues." He is a past president of the Greater Miami Tax Institute. Mr. Nelson is a co-founder and current board member of the Victory Center for Autism and Behavioral Challenges (a not-for-profit corporation) and served as board chairman from 2000-2008.

Cassandra S. Nelson, an associate in the law firm of Nelson & Nelson, P.A. in North Miami Beach, Florida. She practices primarily in the areas of estate planning, asset protection, tax, special needs trusts, guardianships, and probate administration. She has co-authored articles published by *Trust & Estates*, *ActionLine* (Florida Bar), and *Leimberg Information Services*. Cassandra received her B.A. from the University of Miami in 2013 and her J.D. from Emory University School of Law in 2017. Cassandra Nelson is involved with The Victory Center for Autism and Behavioral Challenges (a not-for-profit corporation). As the older sister of a 23-year-old

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brother with severe autism, Cassandra has a unique interest in assisting children with disabilities and their families. As an attorney, she does so by counseling on the creation of special needs trusts and establishing guardianships for such children.

Here is their commentary:

EXECUTIVE SUMMARY:

As a result of the Tax Cuts and Jobs Act of 2017 (the "2017 Tax Act") 2018 provides a unique opportunity for you to make gifts using your federal estate, gift, and generation skipping transfer ("GST") tax exemption (the basic exclusion amount) of \$11.18 Million as reflected in Rev. Proc. 2018-18, issued March 2, 2018 (reduced by any prior use of such exemption).

Unless Congress takes action the increased basic exclusion amount will sunset on December 31, 2025 to \$5 Million, as adjusted by the Consumer Price Index ("CPI"). As a result, if you miss the opportunity to use the increased basic exclusion amount prior to December 31, 2025 you may lose the ability to make significant tax-free gifts. Based upon the current estate and gift tax rate of 40%, the additional estate taxes that may result from not taking advantage of the increased basic exclusion amount of \$11.18 Million before December 31, 2025 could be over \$2.236 Million, or significantly more when appreciation on the gifted assets is taken into account. Unlike in 2012, when taxpayers had only one year to plan for the possible loss of an increased gift tax exemption of \$5 Million, there is no rush to make gifts in 2018. Although taxpayers have until December 31, 2025 to take advantage of the increased gift tax exemption, making gifts sooner rather than later will allow taxpayers to remove future appreciation of gifted assets from their estates. The following 6 Question 2018 Gift Suitability Analysis is provided to facilitate your consideration of whether to make gifts in 2018 (or before January 1, 2026) using the current basic exclusion amount.

COMMENT:

Taxpayers must carefully weigh the loss of a step up in income tax basis for any gifted assets as compared to a step up in basis that would otherwise result if assets are held until death and included in the taxpayer's gross estate. If the gifted assets are actively managed marketable

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securities, the potential loss of a step up in income tax basis may not materially offset the potential estate tax savings and asset protection benefits. However, if (i) it is anticipated that the gifted assets will significantly appreciate in value or (ii) such assets have an income tax basis at the time they are gifted that is less than fair market value and (iii) there is likely to be a large difference between income tax basis as of date of death and estate tax value as of date of death, making gifts could result in an income tax cost that outweighs the estate tax savings of a gift for a net tax loss. This is especially likely for those who do not anticipate having taxable estates of at least \$11.18 Million if single or \$22.36 Million if married, increased by CPI.

For couples who have not made any prior taxable gifts, the potential estate tax savings that may result by taking advantage of the combined basic exclusion amounts of \$22.36 Million is \$4.72 Million. This calculation assumes that the basic exclusion amount is reduced to the \$5 Million basic exclusion amount in effect prior to the 2017 Tax Act, increased by CPI, or \$5.49 Million per person, that gift and estate tax rates remain at 40%, and there is no significant loss of step up in income tax basis for the gifted assets.

All projections should consider: (i) the tax benefits of removing future appreciation on assets gifted from estate, gift, and GST taxes (referred to as "Transfer Taxes") and (ii) the potential loss of a step up in income tax basis for gifted assets. Both factors require careful consideration as to which assets should be gifted and whether the potential Transfer Tax savings will be less than or greater than the loss that will result from not obtaining a step up in income tax basis by holding appreciated assets until death. Asset protection factors further complicate this quantitative analysis. To the extent that assets that could be gifted remain in the hands of the potential debtor, they enhance the amount that could pass to creditors rather than to intended beneficiaries. The analysis below considers such asset protection and tax factors.

If you believe you can afford to make gifts in 2018 (or before January 1, 2026), you must carefully select assets to gift and understand the consequences that may result if such gifts are determined to be undervalued in the event of an IRS audit. Gifts of easy to value assets can be made without concern that the IRS will dispute valuations. In contrast, gifts of closely held businesses and fractional interests in real estate provide leverage in the amount of gifts due to discounts for minority

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ownership and lack of marketability but could become subject to IRS valuation attack.

Whether you should proceed with making gifts of discounted assets now through January 1, 2026 (or earlier should it appear that a change in Congress may result in a reduction of the basic exclusion amount) to leverage use of the enhanced basic exclusion amount depends on your consideration of the following additional factors (the "Additional Factors"):

- (i) the possibility of valuation increases of the gifted assets;
- (ii) the current income tax basis of the gifted assets;
- (iii) whether you are willing to incur the time and expense to defend a gift tax audit;
- (iv) whether you are willing to pay the legal, accounting, and administrative expenses associated with gift planning;
- (v) whether you are willing to sacrifice easy access, or possibly all access, to such gifted assets during your lifetime;
- (vi) whether you have the desire to protect the gifted assets from potential future creditors;
- (vii) whether such gifted assets will be actively managed so that over time it is unlikely that there will be a significant disparity between fair market value and income tax basis of such assets at death, even if there is significant appreciation;
- (viii) whether such gifted assets will be sold in the future versus the likelihood that due to multiple owners, low income tax basis, or any other reason the assets are likely to be retained after death;
- (ix) whether there is a possibility that the low basis assets gifted by you to a trust could be reacquired by you via a power you retain over such trust to transfer other assets you own of equal value to the trust in exchange for the low basis assets originally gifted by you to the trust (a "Substitution Power"), provided other high basis assets are available for you to make such exchange and there is sufficient time to effectuate the Substitution Power; and
- (x) whether you are willing to pay income tax on assets gifted by you to a trust for your intended beneficiaries if the trust is intentionally created as a grantor trust. You can retain the ability to turn off grantor trust status if paying income tax on the gifted assets becomes overly burdensome. Alternatively, or in addition, the trust can provide an independent trustee with the ability to reimburse you for income taxes paid by you attributable to the trust. Many states, including Florida, have enacted legislation which provides

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that the settlor of a trust will not be subject to creditors' claims solely because such trust grants the trustee a discretionary power to pay or reimburse the settlor for income tax on trust income or principal payable by the settlor under law (See, for example, Florida Statutes Section 736.0505(1)(c)).

Some may prefer to "reserve" a portion of their unused basic exclusion amount to offset any potential IRS valuation audit adjustments. However, this approach has pitfalls in and of itself. To the extent the full \$11.18 Million of basic exclusion amount (increased by CPI) is not used and the basic exclusion amount is reduced after December 31, 2025, the "reserve" may be wasted. For example, if you gift discounted assets with an appraised value of \$8 Million and reserve \$3.18 Million of basic exclusion amount in the event of audit, and Congress reduces the basic exclusion amount to \$5 Million, you would lose the ability to make \$3.18 Million of gifts protected from gift tax by the current basic exclusion amount. Although gifts can be made using a number of valuation formulas, which have been recognized in court decisions and limit the value of gifts to avoid taxable gifts in the event the IRS challenges the valuation of such gifts, the IRS may nonetheless challenge the effectiveness of such formulas. Accordingly, you must evaluate your willingness to pay gift taxes or defend valuations in the event of a gift tax audit even if formula gifts are used.

Questions to Help You Determine if You Should Make Gifts Now

The following list of questions is provided to facilitate your consideration of whether to make gifts in 2018 (or before January 1, 2026) using the current basic exclusion amount. All decisions require careful consideration of the current income tax basis of assets to be gifted, projected future appreciation, whether the gifts will be made to a grantor trust that includes a Substitution Power to potentially mitigate the loss of income tax basis, and the extent of potential exposure to creditors' claims (see the Additional Factors, above).

- 1) To save future Transfer Taxes, would you be willing to make 2018 gifts of up to \$5.59 Million (single), \$11.18 Million (jointly with spouse), plus any amount of unused exemption that was available in 2017, \$5.49 Million (single), \$10.98 Million (jointly with spouse), if such gifts can be made free of gift taxes, provided that neither you nor your spouse would have access to such funds, regardless of any reversal in your financial position? Note: If prior taxable gifts were not

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made, each person can make gifts in 2018 of \$11.18 Million (single) or \$22.36 Million (jointly with spouse).

If no, read on. If yes, you are a good candidate for gifting to a trust for your children and grandchildren subject to the Additional Factors.

- 2) To save future Transfer Taxes, would you make 2018 gifts of up to \$5.59 Million, plus any amount of unused Transfer Tax exemption that was available in 2017, \$5.49 Million (single), \$10.98 Million (jointly with spouse), into a trust for your spouse (and possibly your children) where your spouse and children may receive distributions at the discretion of the trustee (you may not be a beneficiary or a trustee). Upon the death of your spouse, the trust assets will be held exclusively for your children (they will not pass back to you even if you survive your spouse).

If no, read on. If yes, you are a good candidate for gifting to a Spousal Limited Access Trust ("SLAT") without a back end retained interest subject to the Additional Factors.

- 3) To save future Transfer Taxes, would you make 2018 gifts of up to \$5.59 Million, plus any amount of unused Transfer Tax exemption that was available in 2017, \$5.49 Million (single), \$10.98 Million (jointly with spouse), into a trust for your spouse (and possibly your children) in 2018 where your spouse and children may receive distributions at the discretion of the trustee (you are not a beneficiary or trustee). Upon your spouse's death, your spouse can decide on whether all or any portion of the assets in the trust revert into a new trust created by your spouse for your benefit and in such event, an independent trustee will determine the extent of distributions to you. Note: Based upon the Relation Back Doctrine (discussed below) it is possible your spouse's decision to distribute all or any portion of the assets back to you into a new trust for your benefit may be considered to be assets held in a self-settled trust created by you for your own benefit rather than a third party created trust created by your spouse. There is a possibility that such a trust, if created in a state that has not adopted domestic self-settled asset protection legislation, will be subject to your creditors' claims and accordingly, such assets may be includible in your estate.

If no, read on. If yes, you are a good candidate for a SLAT that includes a testamentary power of appointment that may be exercised by your spouse

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subject to the Additional Factors and the Relation Back Doctrine issues, described below.

- 4) To save future Transfer Taxes, would you make 2018 gifts of up to \$5.59 Million, plus any amount of unused Transfer Tax exemption that was available in 2017, \$5.49 Million (single), \$10.98 Million (jointly with spouse), into a trust designating your spouse and children as discretionary beneficiaries but providing that on a predetermined future date, the assets are distributed outright or in trust for your children if your net worth is at least a specified value determined upon creation of the trust that you believe would result in you having sufficient assets outside the trust to provide for you and your spouse for the rest of your life?

If no, read on. If yes, you are a good candidate for a SLAT with a predetermined termination formula in favor of your children subject to the Additional Factors.

- 5) To save future Transfer Taxes, would you make a 2018 gift into a trust in one of a number of states that have enacted self-settled asset protection trust legislation (e.g., Alaska, Delaware, South Dakota, or Nevada) or to a foreign asset protection trust jurisdiction where you, your spouse, and possibly your children are potential beneficiaries with the understanding that the IRS may argue that, as a potential trust beneficiary, all trust assets will be included in your estate upon your death (especially if the trustee has exercised its power to make regular distributions to you during your lifetime)? See PLR 200944002, attached, for an IRS ruling in favor of an Alaska resident who created an Alaska self-settled trust (the "Alaska PLR"). Note: The Alaska PLR included important caveats (quoted on page 5 of this letter, below). If you prefer to have greater certainty as to Transfer Tax planning, consider making gifts as described in questions 1-4, above. If you prefer to have greater asset protection certainty, consider making gifts as described in question 6, below.

If yes, you may be a good candidate for a domestic or foreign irrevocable self-settled asset protection trust plan.

- 6) If (i) estate tax savings are not a concern because of the combined \$22.36 Million basic exclusion amount for you and your spouse, (ii) you are comfortable that your net worth, when aggregated with your

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spouse's net worth, will not exceed the basic exclusion amount that may be available in the future understanding that the \$11.18 basic exclusion amount could be reduced, and (iii) you want to significantly enhance asset protection planning, would you transfer significant sums to an inter vivos QTIP trust for your spouse, retaining the right to such trust assets if your spouse predeceases you? If so, would your spouse consider a similar, but not identical, gift into a trust for you?

If no, making gifts of your increased 2018 basic exclusion amount is probably not for you. If yes, you are a candidate for an inter vivos QTIP trust, especially if you are domiciled in Florida or one of the other 16 states that have enacted inter vivos QTIP legislation, which protects trust assets that revert to a trust for the original settlor upon the death of the original donee spouse (i.e., the "Inter Vivos QTIP Trust Jurisdictions"). These states effectively override the Relation Back Doctrine concerns as any "deemed" self-settled trust is disregarded under the Inter Vivos QTIP Jurisdictions statutes because they consider the original donee spouse as the settlor of the trust that is held for the original settlor spouse should the original donee spouse die first. However, be aware of the potential income tax consequences that may arise in the event of divorce and recent repeal of Code Section 682. As a result of these potential consequences a post-nuptial agreement should be a part of any such plan.

The Relation Back Doctrine

If a SLAT is created and the original donee spouse is granted a testamentary power of appointment in favor of the original settlor spouse it is possible the original settlor spouse may be considered the settlor of the new trust rather than the person who exercised the power of appointment being considered to be the settlor. A creditor of the original settlor spouse could argue that under the Relation Back Doctrine: (i) the exercise of a special power of appointment by the original donee spouse constitutes a transfer "from the donor of the power, not from the donee"ⁱ and (ii) the power of appointment is "conceived to be merely an authority to the power holder to do an act for the creator of the power."ⁱⁱ "The appointment is said to 'relate back' to the time of the creation of the power and to operate as if it had been originally contained in [the creator of the power's] will."ⁱⁱⁱ Cases involving the Relation Back Doctrine have typically been in conjunction with whether trust assets subject to a general power of appointment should be

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considered when determining fiduciary fees upon the death of the donee spouse who exercised such power.

In *In re Estate of Wylie*, a husband created a testamentary trust for his wife. At his death, wife received all the income from the trust for her life and had a general power of appointment over the corpus of the trust at her death.^{iv} The issue on appeal was whether the value of the husband's trust was includible in wife's estate for purposes of determining fiduciary fees because she exercised her general power of appointment by her last will and codicil in favor of her testamentary trustees, and the assets were distributed and paid to the trustees.^v The court found the determinative question to be whether the power of appointment should be characterized as an interest in property or merely a mandate or authority to dispose of property.^{vi} The court noted that:

The doctrine of relation back, minimizing as it does the importance of the donee of the power, is the mainstay for that rule of law which treats the donee as a mere agent with no property interest. Although under attack by many commentators in the field of future interests, the prevailing view still remains that a general power of appointment is a mere mandate or authority to dispose of property and not an interest in property itself.^{vii}

In keeping with the historical origin of powers of appointment and the "spirit of the law," the court in *Wylie* held that the power of appointment was an authority to dispose of property and not an interest in property.^{viii}

Although none of the reported cases regarding the Relation Back Doctrine address its application to the settlor of a QTIP or SLAT who receives trust assets upon the death of the donee spouse through the exercise of a special power of appointment, Inter Vivos QTIP Trust Jurisdictions provide greater protection for inter vivos QTIP trust settlors by avoiding any possible Relation Back Doctrine attack.

Can SLATs Provide Better Overall Tax Results as Compared to QTIP Trusts Without the Loss of Asset Protection?

The inter vivos QTIP trust plan has limitations when compared to a similar plan using SLAT gifts to freeze estate tax values. For example, some attorneys have suggested planning to take advantage of the basic exclusion amount by making gifts in 2018 to SLATs using a taxpayer's

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remaining basic exclusion amount. The growth on any assets remaining in the SLAT will pass estate tax-free upon the death of the beneficiary spouse, even if the basic exclusion amount is reduced by Congress upon the date of death of the beneficiary spouse and even if the initial gifted assets appreciated significantly within the SLAT. The problem with using the inter vivos QTIP plan rather than a gift into a SLAT is that most Inter Vivos QTIP Trust Jurisdictions require that a gift tax QTIP election be made to obtain the asset protection benefit (that the beneficiary spouse is considered the settlor and not the initial settlor of the inter vivos QTIP) upon the death of the initial donee spouse.^{ix} In such event, the assets in the QTIP trust will be included in the estate of the initial donee spouse at fair market value upon the death of the initial donee spouse. If the plan is to make the SLAT assets available for the surviving spouse who created the initial trust, there is a possibility such assets will be subject to inclusion in the estate of such spouse under Code Sections 2036 or 2041, as the creditors of the initial settlor spouse may be able to reach such assets upon the death of the first spouse. While Treas. Reg. Section 25.2523(f)- 1(f), Example 11, provides that assets held in an inter vivos QTIP trust — for the benefit of the donor (Note: Treasury Regulations refer to the original trust creator as the donor rather than the settlor) after the death of his or her spouse — will not be includible in the donor's taxable estate under Code Sections 2036 and 2038, no similar regulation exists for SLATs. It would appear that the favorable treatment is provided by said Regulation based upon the fact that such assets are includible in the estate of the donee spouse under Section 2044 which is not the case with a SLAT. Accordingly the tax treatment of assets reverting back to the original donor of a SLAT may be subject to estate tax.

Arizona, Kentucky, North Carolina, Tennessee and Texas' Statutes May Create Asset Protection and Estate Tax Benefits (but it may not!)

Arizona Statutes Section 14-10505(E) states:

For the purposes of this section, amounts and property contributed to the following trusts are not deemed to have been contributed by the settlor, and a person who would otherwise be treated as a settlor or a deemed settlor of the following trusts shall not be treated as a settlor:

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1. An irrevocable inter vivos marital trust that is treated as qualified terminable interest property under section 2523(f) of the internal revenue code if the settlor is a beneficiary of the trust after the death of the settlor's spouse.
2. An irrevocable inter vivos marital trust that is treated as a general power of appointment trust under section 2523(e) of the internal revenue code if the settlor is a beneficiary of the trust after the death of the settlor's spouse.
3. An irrevocable inter vivos trust for the settlor's spouse if the settlor is a beneficiary of the trust after the death of the settlor's spouse.
- 4. An irrevocable trust for the benefit of a person, the settlor of which is the person's spouse, regardless of whether or when the person was the settlor of an irrevocable trust for the benefit of that spouse.[Emphasis Added.]**
5. An irrevocable trust for the benefit of a person to the extent that the property of the trust was subject to a general power of appointment in another person.^x

North Carolina, N.C. Gen Stat. Section 36C-5-505(c) states:

Subject to the Uniform Voidable Transactions Act, Article 3A of Chapter 39 of the General Statutes, for purposes of this section, property contributed to the following trusts is not considered to have been contributed by the settlor and a person who would otherwise be treated as a settlor or deemed settlor of the following trusts may not be treated as a settlor:

- (1) If the settlor is a beneficiary after the death of the settlor's spouse:

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- a. An irrevocable inter vivos marital trust that is treated as a general power of appointment trust described in section 2523(e) of the Internal Revenue Code.
- b. An irrevocable inter vivos marital trust that is treated as a qualified terminable interest trust under section 2523(f) of the Internal Revenue Code.
- c. An irrevocable inter vivos trust of which the settlor's spouse is a beneficiary during the spouse's lifetime but which does not qualify for the federal gift tax marital deduction, and during the lifetime of the settlor's spouse (i) the settlor's spouse is the only beneficiary or (ii) the settlor's spouse and the settlor's issue are the only beneficiaries. [Emphasis added.]***
- d. Another trust, to the extent that the property of the other trust is attributable to property passing from a trust described in sub-subdivisions a., b., and c. of this subdivision. [Emphasis added.]^{xi}*

For purposes of this subdivision, notwithstanding the provisions of G.S. 36C-1-103(3), the settlor is a beneficiary whether so named under the initial trust instrument or through the exercise of a limited or general power of appointment.

(2) An irrevocable inter vivos trust for the benefit of a person if the settlor is the person's spouse, regardless of whether or when that person was a settlor of an irrevocable inter vivos trust for the benefit of the person's spouse.

For purposes of this subsection, the "settlor's spouse" refers to the person to whom the settlor was married at the time the irrevocable inter vivos trust was created, notwithstanding a subsequent dissolution of the marriage.

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Arizona, Kentucky, North Carolina, Tennessee, and Texas provide that the initial settlor of an inter vivos irrevocable trust created for the settlor's spouse will not be deemed to have been contributed by the settlor if the settlor is the beneficiary of the trust after the death of the settlor's spouse, even if there is no QTIP election.^{xii}

While at first glance the Arizona, Kentucky, North Carolina, Tennessee and Texas statutes appear to create great asset protection and the possibility of enhanced estate tax benefits that are afforded to SLATs as compared to an inter vivos QTIP Trusts (i.e., all appreciation of assets in the SLAT would avoid future estate taxes and regardless of whether the applicable exclusion amount is reduced the assets in the SLAT should not be subject to estate tax inclusion), there are two potential pitfalls to the Arizona, Kentucky, North Carolina and Texas statutes: (1) the trust needs to have their situs in Arizona, Kentucky, North Carolina, Tennessee and/or Texas, as the case may be, and be subject to income tax there; and (2) there is no provision similar to IRS Treas. Reg. Section 25.2523(f)-1(f), Example 11 that assures that the initial settlor will not be subject to tax under Code Sections 2036 or 2038. As a result, the IRS could take the position that despite state law, the initial settlor has an interest under Code Sections 2036 and 2038, resulting in estate tax inclusion, and (iii) loss of step up in income tax basis.

Providing the initial donee of a SLAT a special power of appointment to direct the SLAT assets back to the initial settlor, as compared to retaining a reversion in a SLAT in favor of the settlor, may not change the estate tax consequences to the settlor due to the Relation Back Doctrine described above.^{xiii} As a result, assets passing from SLAT back to a credit shelter trust for the initial settlor may be considered to be held in a self-settled trust and therefore subject to estate tax inclusion for the settlor spouse.

Some have suggested the creation of the initial SLAT in a jurisdiction that recognizes and protects self-settled asset protection trusts.^{xiv} The IRS has ruled favorably for a trust created under Alaska law.^{xv} A thorough analysis of this issue is beyond the scope of these materials. However, creation of a SLAT, in one of the 17 states that have enacted self-settled asset protection trusts,^{xvi} does not assure that trust assets will be excluded from the initial settlor's gross estate if they are appointed back to the initial settlor, especially if there was an implied agreement that the assets would revert to the settlor and there is a pattern of distributions to the settlor. For example PLR 2009440002, which is frequently cited as support that the

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creation of an irrevocable Trust in a self-settled asset protection jurisdiction such as Alaska is a completed gift and assets will not be included in the Grantor's gross estate says: "We are specifically not ruling on whether Trustee's discretion to distribute income and principal of Trust to Grantor combined with other facts (such as, but not limited to, an understanding or pre-existing arrangement between Grantor and trustee regarding the exercise of this discretion) may cause inclusion of Trust's assets in Grantor's gross estate for federal estate tax purposes under Section 2036."^{xvii} My concern is since Treas. Reg. Section 25.2523(f)-1(f), Example 11 assures that the trust reverting to the original settlor from an inter vivos QTIP trust created for the donee spouse is protected from estate tax inclusion under Code Sections 2036 or 2038 (and further protected in states such as Florida and Arizona with a state statute that says the settlor's spouse is deemed the settlor when assets pass back to the settlor spouse), that the inter vivos QTIP result is as close as definite as you get that such assets will not be includible in the gross estate of the original settlor spouse. The SLAT approach does not have a Treasury Regulation that says the original settlor will not be taxed under Code Sections 2036 or 2038. Further, most inter vivos QTIP statutes (such as Florida's) specifically say the initial donee spouse is deemed to be the settlor when trust assets revert in trust for the original settlor spouse, only if a QTIP election was made.^{xviii} If a state statute does not shift settlor status to the original donee spouse from the original settlor spouse, then assets may be includible in the gross estate of the original settlor under Code Section 2036 if the IRS successfully asserts there was an understanding or pre-existing arrangement regarding the trustee's exercise of discretion in favor of the original settlor spouse.

Options for you to consider are: (i) use of an Inter Vivos QTIP Trust Jurisdictions, (ii) use of a combination of an inter vivos QTIP trust created by one spouse and a SLAT created by another spouse where the QTIP assets will revert to the initial settlor upon the death of the initial donee spouse and the assets of the SLAT pass to children (and not in trust for the initial settlor spouse) upon the death of the donee spouse, or (iii) if more aggressive, use of multiple SLATs, possibly in states or countries with favorable self settled asset protection laws. Life insurance could be purchased on the life of the donee spouse of the SLAT to replace assets that will pass to children upon the death of the donee spouse beneficiary of the SLAT.

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Conclusion

If you answered yes to any of the above questions, now is a good time to proceed. Whatever you believe, benefits of current transfers generally include enhanced asset protection and the shifting of future appreciation without paying Transfer Taxes provided the loss of step up in income tax basis is considered. Now is a good time to start the conversation.

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

Barry A. Nelson

Cassandra S. Nelson

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CITATIONS:

ⁱ *In re Estate of Wylie*, 342 So.2d 996, 998 (Fla. 4th DCA 1977) (quoting RESTATEMENT (FIRST) OF PROPERTY § 318 comment (b) (1940)).

ⁱⁱ American Law Institute, *Donative Transfers* vol. 2 §§ 11.1-24.4, in RESTATEMENT (SECOND) OF PROPERTY 4 (1986).

ⁱⁱⁱ *Id.*

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^{iv} *In re Estate of Wylie*, 342 So.2d at 996-97.

^v *Id.* at 998.

^{vi} *Id.* at 999.

^{vii} *Id.* at 998.

^{viii} *Id.*

^{ix} ARIZ. REV. STAT. ANN. § 14-10505(E); ARK. CODE ANN. § 28-73-505(c); DEL. CODE ANN. TIT. 12 § 3536(c); FLA. STAT. § 736.0505(3); KY. REV. STAT. ANN. § 386B.5-020(8)(A); MD. CODE ANN., EST. & TRUSTS § 14.5-1003(a)(1)-(2); MICH. COMP. LAWS § 700.7506(4); New Hampshire Chapter 564-B:5-505(a)(2)(C)-(D); N.C.GEN. STAT. § 36C-5-505(C); OHIO REVISED CODE § 5805.06(B)(3); OR. REV. STAT. § 130.315(4); S.C. CODE ANN. § 62-7-505(b)(2); TENN. CODE ANN. § 35-15-505(d); TEX. PROP. CODE ANN. § 112.035(g); VA. CODE ANN. §64.2-747.B(2); Wisc. STAT. ANN. § 701.0505(2)(E); WYO. STAT. ANN. § 4-10-506(e).

^x ARIZ STAT. § 14-10505(E). See also TEX. PROP. CODE § 112.035(g)(3)(A).

^{xi} N.C. GEN STAT. § 36C-5-505(c). See also KY. REV STAT ANN § 386B.5-020(8)(a)(1)-(3).

^{xii} ARIZ STAT. § 14-10505(E); KY. REV STAT. ANN § 386B.5-020(8)(a)(1)-(3); N.C. GEN STAT. § 36C-5-505(c); TENN. CODE ANN § 35.15-505(f); TEX. PROP. CODE § 112.035(g).

^{xiii} *In re Estate of Wylie*, 342 So.2d at 998.

^{xiv} Carol G. Kroch et al., *Taking a Fresh Look at Lifetime Gift Planning Opportunities*, 38 EST. PLAN. 3, 14 (Sept. 2011); Gans, Blattmachr & Zeydel, *supra*, note 14, at 59.

^{xv} Gideon Rothschild et al., *IRS Rules Self-Settled Alaska Trust Will Not Be In Grantor's Estate*, 37 EST. PLAN 3, 13 (Jan. 2010).

^{xvi} ALASKA STAT. §§ 13.36.310, 34.40.110; DEL. CODE ANN. TIT. 12, §§3570-3576; HAW. REV. STAT. § 554g; Mich. Comp. Laws 700.1041-.1050; Miss. Code Ann. §§91-9-701 – 91-9-723; Mo. REV. STAT. §§456.5-505; N.H. REV.

STAT. ANN. § 564-B:8-5-505(A)(2)(C)-(D); NEV. REV. STAT. §§116.010-166.170; OHIO LEGACY TRUST ACT, CHAPTER 5816 OF THE OHIO REVISED CODE; OKLA. STAT. ANN. Tit. 31, § 10-18; R.I. GEN. LAWS § 18-9.2-1 – 18-9.2-7; S.D. CODIFIED LAWS §§55.16-1–55-16-17; TENN. CODE ANN. § 35-16-101-112 ; UTAH CODE ANN. §25-6-14 (Repealed And Re-Enacted In 2013); VA. CODE ANN. § 64.2-745.1 and 64.2-745.2; W. VA. CODE SECTIONS 44D-5-503A, 44D-5-503B; 44D-5-503c; AND 44D-5-505; WYO. STAT. §§4-10-505 & 4-10-510–523.

^{xvii} PLR 200944002.

^{xviii} FLA. STAT. § 736.0505(3)(a).

EXHIBIT 2

Code Section 2523(f)

(a) Allowance of deduction

Where a donor transfers during the calendar year by gift an interest in property to a donee who at the time of the gift is the donor's spouse, there shall be allowed as a deduction in computing taxable gifts for the calendar year an amount with respect to such interest equal to its value.

(b) Life estate or other terminable interest

Where, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, such interest transferred to the spouse will terminate or fail, no deduction shall be allowed with respect to such interest—

(1) if the donor retains in himself, or transfers or has transferred (for less than an adequate and full consideration in money or money's worth) to any person other than such donee spouse (or the estate of such spouse), an interest in such property, and if by reason of such retention or transfer the donor (or his heirs or assigns) or such person (or his heirs or assigns) may possess or enjoy any part of such property after such termination or failure of the interest transferred to the donee spouse; or

(2) if the donor immediately after the transfer to the donee spouse has a power to appoint an interest in such property which he can exercise (either alone or in conjunction with any person) in such manner that the appointee may possess or enjoy any part of such property after such termination or failure of the interest transferred to the donee spouse. For purposes of this paragraph, the donor shall be considered as having immediately after the transfer to the donee spouse such power to appoint even though such power cannot be exercised until after the lapse of time, upon the occurrence of an event or contingency, or on the failure of an event or contingency to occur.

An exercise or release at any time by the donor, either alone or in conjunction with any person, of a power to appoint an interest in property, even though not otherwise a transfer, shall, for purposes of paragraph (1), be considered as a transfer by him. Except as provided in subsection (e), where at the time of the transfer it is impossible to ascertain the particular person or persons who may receive from the donor an interest in property so transferred by him, such interest shall, for purposes of paragraph (1), be considered as transferred to a person other than the donee spouse.

(c) Interest in unidentified assets

Where the assets out of which, or the proceeds of which, the interest transferred to the donee spouse may be satisfied include a particular asset or assets with respect to which no deduction would be allowed if such asset or assets were transferred from the donor to such spouse, then the value of the interest transferred to such spouse shall, for purposes of subsection (a), be reduced by the aggregate value of such particular assets.

(d) Joint interests

If the interest is transferred to the donee spouse as sole joint tenant with the donor or as tenant by the entirety, the interest of the donor in the property which exists solely by reason of the possibility that the donor may survive the donee spouse, or that there may occur a severance of the tenancy, shall not be considered for purposes of subsection (b) as an interest retained by the donor in himself.

(e) Life estate with power of appointment in donee spouse

Where the donor transfers an interest in property, if by such transfer his spouse is entitled for life to all of the income from the entire interest, or all the income from a specific portion thereof, payable annually or at more frequent intervals, with power in the donee spouse to appoint the entire interest, or such specific portion (exercisable in favor of such donee spouse, or of the estate of such donee spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), and with no power in any other person to appoint any part of such interest, or such portion, to any person other than the donee spouse—

(1) the interest, or such portion, so transferred shall, for purposes of subsection (a) be considered as transferred to the donee spouse, and

(2) no part of the interest, or such portion, so transferred shall, for purposes of subsection (b)(1), be considered as retained in the donor or transferred to any person other than the donee spouse.

This subsection shall apply only if, by such transfer, such power in the donee spouse to appoint the interest, or such portion, whether exercisable by will or during life, is exercisable by such spouse alone and in all events. For purposes of this subsection, the term "specific portion" only includes a portion determined on a fractional or percentage basis.

(f) Election with respect to life estate for donee spouse

(1) In general In the case of qualified terminable interest property—

(A) for purposes of subsection (a), such property shall be treated as transferred to the donee spouse, and

(B) 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.

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(2) Qualified terminable interest property For purposes of this subsection, the term “qualified terminable interest property” means any property—

- (A) which is transferred by the donor spouse,
- (B) in which the donee spouse has a qualifying income interest for life, and
- (C) to which an election under this subsection applies.

(3) Certain rules made applicable For purposes of this subsection, rules similar to the rules of clauses (ii), (iii), and (iv) of section 2056(b)(7)(B) shall apply and the rules of section 2056(b)(10) shall apply.

(4) Election

(A) **Time and manner** An election under this subsection with respect to any property shall be made on or before the date prescribed by section 6075(b) for filing a gift tax return with respect to the transfer (determined without regard to section 6019(2)) and shall be made in such manner as the Secretary shall by regulations prescribe.

(B) **Election irrevocable** An election under this subsection, once made, shall be irrevocable.

(5) Treatment of interest retained by donor spouse

(A) **In general** In the case of any qualified terminable interest property—

- (i) such property shall not be includible in the gross estate of the donor spouse, and
- (ii) any subsequent transfer by the donor spouse of an interest in such property shall not be treated as a transfer for purposes of this chapter.

(B) **Subparagraph (A) not to apply after transfer by donee spouse** Subparagraph (A) shall not apply with respect to any property after the donee spouse is treated as having transferred such property under section 2519, or such property is includible in the donee spouse’s gross estate under section 2044.

(6) Treatment of joint and survivor annuities In the case of a joint and survivor annuity where only the donor spouse and donee spouse have the right to receive payments before the death of the last spouse to die—

(A) the donee spouse’s interest shall be treated as a qualifying income interest for life,

(B) the donor spouse shall be treated as having made an election under this subsection with respect to such annuity unless the donor spouse otherwise elects on or before the date specified in paragraph (4)(A),

(C) paragraph (5) and section 2519 shall not apply to the donor spouse’s interest in the annuity, and

(D) if the donee spouse dies before the donor spouse, no amount shall be includible in the gross estate of the donee spouse under section 2044 with respect to such annuity.

An election under subparagraph (B), once made, shall be irrevocable.

(g) Special rule for charitable remainder trusts

(1) **In general** If, after the transfer, the donee spouse is the only noncharitable beneficiary (other than the donor) of a qualified charitable remainder trust, subsection (b) shall not apply to the interest in such trust which is transferred to the donee spouse.

(2) **Definitions** For purposes of paragraph (1), the term “noncharitable beneficiary” and “qualified charitable remainder trust” have the meanings given to such terms by section 2056(b)(8)(B). [1]

(h) Denial of double deduction

Nothing in this section or any other provision of this chapter shall allow the value of any interest in property to be deducted under this chapter more than once with respect to the same donor.

(i) Disallowance of marital deduction where spouse not citizen If the spouse of the donor is not a citizen of the United States—

(1) no deduction shall be allowed under this section,

(2) section 2503(b) shall be applied with respect to gifts which are made by the donor to such spouse and with respect to which a deduction would be allowable under this section but for paragraph (1) by substituting “\$100,000” for “\$10,000”, and

(3) the principles of sections 2515 and 2515A (as such sections were in effect before their repeal by the Economic Recovery Tax Act of 1981) shall apply, except that the provisions of such section 2515 providing for an election shall not apply.

This subsection shall not apply to any transfer resulting from the acquisition of rights under a joint and survivor annuity described in subsection (f)(6).

(Aug. 16, 1954, ch. 736, 68A Stat. 412; Pub. L. 91-614, title I, § 102(c)(3), Dec. 31, 1970, 84 Stat. 1841; Pub. L. 94-455, title XIX, § 1902(a)(12)(E), title XX, § 2002(b), Oct. 4, 1976, 90 Stat. 1806, 1854; Pub. L. 97-34, title IV, § 403(b)(1), (2), (d)(2), Aug. 13, 1981, 95 Stat. 301, 303; Pub. L. 97-448, title I, § 104(a)(2)(B), (4)-(6), Jan. 12, 1983, 96 Stat. 2380, 2381; Pub. L. 99-514, title XVIII, § 1879(n)(1), Oct. 22, 1986, 100 Stat. 2910; Pub. L. 100-647, title V, § 5033(b), title VI, § 6152(b), Nov. 10, 1988, 102 Stat. 3672, 3725; Pub. L. 101-239, title VII, § 7815(d)(1)(A), (2), Dec. 19, 1989, 103 Stat. 2415; Pub. L. 101-508, title XI, § 11702(g)(1), Nov. 5, 1990, 104 Stat. 1388-515; Pub. L. 102-486, title XIX, § 1941(b), Oct. 24, 1992, 106 Stat. 3036; Pub. L. 105-34, title XVI, § 1604(g)(4), Aug. 5, 1997, 111 Stat. 1099.)

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ACTEC Response to Notice 2018-37



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Please Address Reply to:

July 2, 2018

Internal Revenue Service
CC:PA:LPD:PR (Notice 2018-37)
Room 5203
Post Office Box 7604
Ben Franklin Station
Washington, D.C. 20044

Submitted electronically at Comments@irs.counsel.treas.gov

Re: Comments on guidance in connection with the Repeal of Section 682

Dear Ladies and Gentlemen,

The American College of Trust and Estate Counsel ("ACTEC") is pleased to submit comments pursuant to Notice 2018-37, 2018-18 I.R.B. 392, released on April 13, 2018. The Notice requests comments on whether guidance is needed regarding the application of Sections 672(e)(1)(A), 674(d), and 677 of the Internal Revenue Code following a divorce or legal separation, in light of the repeal of Code Section 682.

Notice 2018-37 states that the Department of the Treasury and the Internal Revenue Service intend to issue regulations providing clarification of the application of the effective date provisions concerning the repeal of Code Section 682, enacted on December 22, 2017, by P.L. 115-97 (the 2017 Act).

ACTEC is a professional organization of approximately 2,500 lawyers from throughout the United States. Fellows of ACTEC are elected to membership by their peers on the basis of professional reputation and ability in the fields of trusts and estates and on the basis of having made substantial contributions to those fields through lecturing, writing, teaching, and bar activities. Fellows of ACTEC have extensive experience in providing advice to taxpayers on matters of federal taxes, with a focus on estate, gift and GST tax planning, fiduciary income tax planning, and compliance. ACTEC offers technical comments about the law and its effective administration, but does not take positions on matters of policy or political objectives.

ACTEC's comments and recommendations are set forth in the attached memorandum.

If you or your staff would like to discuss the comments or recommendations, please contact Beth Shapiro Kaufman, Chair of the ACTEC Washington Affairs Committee,

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at (202) 862-5062 or bkaufman@capdale.com, or Deborah McKinnon, ACTEC Executive Director, at (202) 684-8460 or domckinnon@actec.org.

Respectfully submitted,

A handwritten signature in cursive script that reads "Charles D. Fox IV". The signature is written in black ink and is positioned above a horizontal line.

Charles D. Fox IV
President

Enclosures

EXHIBIT 3

COMMENTS OF THE AMERICAN COLLEGE OF TRUST AND ESTATE COUNSEL ON APPLICATION OF CODE §§ 672(e)(1)(A), 674(c), 674(d), 676 AND 677 AFTER THE REPEAL OF CODE § 682

The American College of Trust and Estate Counsel (ACTEC) is pleased to submit these comments in response to Notice 2018-37, 2018-18 I.R.B. 392, released on April 13, 2018. The Notice requests comments on whether guidance is needed regarding the application of §§ 672(e)(1)(A), 674(d), and 677 of the Internal Revenue Code (Code) following a divorce or legal separation, in light of the repeal of Code § 682.

Notice 2018-37 states that the Department of the Treasury and the Internal Revenue Service intend to issue regulations providing clarification of the application of the effective date provisions concerning the repeal of § 682, enacted on December 22, 2017, by P.L. 115-97 (the 2017 Act).

BACKGROUND

Part I of Subchapter J of the Code deals with the income taxation of trusts. The potential income tax consequences for the grantor of a trust are addressed in Subpart E of Subchapter J and in § 682, which is part of Subpart F of Subchapter J. When Subpart E applies to the grantor of a trust, the grantor is treated under § 671 as the owner of a portion or all of a trust and takes into account in computing his or her income tax all of the income, deductions, and credits that are attributable to the portion of the trust treated as owned by him or her.¹

Section 11051 of the 2017 Act repealed § 682, effective for taxpayers whose divorce or separation instruments are executed after December 31, 2018.

Code § 682. As in effect prior to the 2017 Act, § 682 provided rules describing how the income² of a trust is taxed if it is payable to a spouse or a former spouse of the trust's grantor from whom the taxpayer is divorced or legally separated under a decree of divorce or separate maintenance or under a written separation agreement.³ Under § 682 this income was includible in the gross income of the grantor's former spouse and was not includible in the grantor's gross income, despite any other provision of Subtitle A of the Internal Revenue Code, including the normal rules of Subpart E.⁴

¹ A trust that is treated as owned by its grantor is generally referred to as a "grantor trust." Subpart E, § 678 also treats some trust beneficiaries who have or had unilateral withdrawal rights over trust property as the owner of a portion or all of a trust. The issues discussed in these comments could affect these beneficiaries in a manner similar to the way they affect grantors. For convenience, these comments refer to any affected taxpayer as the "grantor" of the trust.

² For purposes of Subpart E of Subchapter J, Treas. Reg. § 1.671-2(b) provides that "income" means taxable income and not only income for fiduciary accounting purposes. It is unclear what the term income means for purposes of former § 682, which was in Subpart F of Subchapter J.

³ References in these comments to "former spouse" include existing spouses from whom the grantor is separated under a decree of separate maintenance or a written separation agreement.

⁴ Treas. Reg. § 1.682(a)-1(a)(1) provides "under section 682(a) income of a trust— (i) [w]hich is paid, credited, or required to be distributed to the wife in a taxable year of the wife, and (ii) [w]hich, except for the provisions of section 682, would be includible in the gross income of her husband, is includible in her gross income and is not includible in his gross income."

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Code § 682(b) also applied for purposes of computing the taxable income of the trust and the taxable income of the grantor's former spouse to whom § 682(a) applied. It provided that the grantor's former spouse was considered the beneficiary of the trust for purposes of Part I of Subchapter J (§§ 641-685).

The predecessor of § 682 was § 171 of the Internal Revenue Code of 1939 (the "1939 Code"). It entered the Code as part of the Revenue Act of 1942. The legislation also provided an income tax deduction for the periodic payments a husband made to his wife under a decree of divorce or separate maintenance in discharge of a legal obligation imposed on him because of the marital relationship ("alimony"). It required the wife to include the alimony payments in her gross income.⁵

The alimony inclusion provision, § 22(k) of the 1939 Code, also required a wife who received periodic payments attributable to property transferred in trust or otherwise to include the payments received in her gross income if the property was transferred in discharge of an obligation imposed on the husband on account of the marital relationship. Payments so included would be excluded from the gross income of the husband.

The narrow purpose of § 171 was to give the husband who had created a trust or was the beneficiary of a trust created before his divorce or separation the income from which was payable to his wife the same tax treatment that § 22(k) gave the husband who created a trust in connection with his divorce.⁶ It required the wife who was divorced or legally separated from her husband under a decree of divorce or separate maintenance to include in her gross income the amount of income paid to her from any trust that, in the absence of § 171, would have been taxable to the husband. It also provided that the husband could exclude this income from his gross income whether or not the income would ordinarily be taxable to him under §§ 166 or 167 of the 1939 Code or any other provisions of the income tax law.

Sections 166 and 167 were the only provisions of the grantor trust rules that were in existence in 1942. Section 166 was the predecessor of current § 676. Section 167 was the predecessor of § 677. In 1942, neither of these sections was triggered by the existence of an interest in or power over a trust in a grantor's spouse. Each of these sections is discussed more fully below.

Sections 22(k), 23(u) and 171 were imported into the 1954 Code as §§ 71, 215, and 682. The scope of these sections was changed in 1986. One of the changes to § 71 eliminated the requirement that a spouse include in his or her gross income periodic payments from property transferred in discharge of an obligation imposed on the other spouse on account of the marital relationship. It also eliminated the exclusion from gross income that benefitted the other spouse. But § 682 was left in place to fill the gap. Until its repeal, § 682 protected a spouse who would otherwise be taxed on trust income under the grantor trust rules or otherwise from taxation to the extent trust income was payable to his or her former spouse.

⁵ 1939 Code §§ 22(k) and 23(u). The 1939 Code referred to the payor of alimony as the husband and the recipient as the wife because in 1939 the obligation to make alimony payments was imposed only on the husband.

⁶ J. Seidman, *Legislative History of Federal Income Tax and Excess Profits Tax Laws 1953-1939, 1275-85* (1954).

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The 2017 Act repealed § 682, as well as § 215, the section that permitted a taxpayer to deduct his or her alimony payments made to the other spouse. One of the conforming amendments to the repeal of the alimony deduction was the repeal of § 71, the section that required the recipient of alimony payments to include the payments in gross income. The 2017 Act described the repeal of § 682 as an additional conforming amendment to the repeal of § 215.

Given the original purpose of § 682, its repeal in connection with the repeal of the alimony deduction is not surprising. Section 682 was originally intended to protect a grantor from a requirement to include trust income payable to his former wife in his gross income if the trust principal or income could revert to him within the meaning of current §§ 676 or 677. But the scope of the grantor trust rules in Subpart E has expanded substantially since 1942. As a result, the role of § 682 had become more robust. Under current law, the grantor trust rules apply to a trust not only when trust income can be used for the benefit of the grantor, but also when the income can be used for the benefit of the grantor's spouse and when the grantor, the grantor's spouse, or certain others have certain controls over the trust.

Code § 672(e)(1)(A): the Spousal Unity Rule. Subpart E of Subchapter J of the 1954 Code as originally enacted referred to the grantor's spouse in only two provisions. Section 672(c) provided that the term "related or subordinate party" includes any nonadverse party who is the *grantor's spouse if living with the grantor*. Section 674(d) addresses the power to control the beneficial enjoyment of the corpus or the income of a trust held by trustees none of whom is the grantor *or spouse living with the grantor*, if the power is limited by a reasonably definite external standard. As described below, amendments to the Code in 1969 and 1986 expanded the circumstances in which the possession of an interest or power by the grantor's spouse triggered the grantor trust rules.

Section 672(e)(1)(A) (the "spousal unity rule") provides that, for purposes of Subpart E of Subchapter J, a grantor is treated as holding any power or interest held by any individual who was the grantor's spouse at the time of the creation of the power or interest. As originally enacted by the Tax Reform Act of 1986, the text of § 672(e) was as follows:

(e) Grantor Treated as Holding Any Power or Interest of Grantor's Spouse.—For purposes of this subpart, if a grantor's spouse is living with the grantor at the time of the creation of any power or interest held by such spouse, the grantor shall be treated as holding such power or interest.

An amendment in the 1988 Act to § 672(e) changed its scope by providing that the rule also applies (1) to any power or interest held by an individual who became the spouse of a grantor after the creation of the power or interest (but only after the marriage), and (2) whether or not the grantor and his or her spouse were living together at the time of the creation of the power or interest. The amendment also provided that the rule does not apply to any power or interest created in the spouse if, at the time of the creation of the power or interest, they are legally separated under a decree of divorce or of separate maintenance.

There are a number of provisions in Subpart E the operation of which depend on whether a particular individual is the grantor's spouse. The impact of § 672(e) on the application of many of

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these provisions when that individual is the grantor's former spouse has long been unclear. Section 672(e) itself says nothing about the application of the spousal unity rule if the spouses divorce or legally separate after the creation of the power or interest.

Some commentators believe that § 672(e)(1)(A) is applicable in any situation in which a grantor is treated as the owner of a portion of a trust in Subpart E of Subchapter J on account of a spousal interest or power, even following divorce. The support for this belief is the failure of § 672(e) to address directly the question of whether the spousal unity rule ends when the marriage ends.⁷

The 1988 Act amended two other provisions of Subpart E, §§ 674(c) and 675(3). Section 674(c) addresses the power to control the beneficial enjoyment of the corpus or the income of a trust held by trustees when "none of whom is the grantor." Section 675(3) addresses situations in which the grantor has borrowed the corpus or income of a trust and has not completely repaid the loan before the beginning of the taxable year.

The 1988 Technical Corrections to the Tax Reform Act of 1986 added a sentence to the end of both § 674(c) and § 675(3) providing that "[f]or periods during which an individual is the spouse of the grantor (within the meaning of section 672(e)(2)), any reference in this subsection to the grantor shall be treated as including a reference to such individual." With respect to § 674(c), this language suggests that the spousal unity rule should apply only if the spouses are married during the period of time the grantor's spouse is serving as a trustee. However, as discussed below, § 672(e) could be applied in a manner inconsistent with the sentence added by the 1988 Technical Corrections. The statutes do not resolve this apparent inconsistency. .

As noted above § 674(d) addresses a power to control the beneficial enjoyment of trust income or principal held by trustees none of whom is the grantor or grantor's spouse **living with the grantor**, if the power is limited by a reasonably definite external standard. This provision has not been modified since it became part of Subpart E in 1954 and seems to look to the marital status of a trustee at the time he or she is serving as a trustee.

It seems clear from the language added in 1988 and from § 674(d) that, if an individual is legally separated from his or her spouse under a decree of divorce or of separate maintenance (or not living together with respect to § 674(d)), the spousal unity rule should not be applied for purposes of §§ 674(c), 674(d), and 675(3). This is illustrated by the following examples.

Example 1. If a power held by the grantor's spouse prevents the § 674(c) exception to grantor trust treatment under § 674(a) from applying, after the date of the grantor's divorce the fact that the grantor's former spouse continues to hold that power will no longer cause the grantor to be treated as the owner of the trust.

Example 2. If a power held by the grantor's spouse who is living with the grantor prevents the § 674(d) exception to grantor trust treatment under § 674(a) from applying, after the date of the grantor's divorce the fact that the grantor's former spouse continues to hold that power will no longer cause the grantor to be treated as the owner of the trust.

⁷ Professor Jeffrey N. Pennell notes that "[c]uriously, § 672(e) does not indicate whether spousal unity ends when the marriage does." Footnote 36, Chapter 5 of Casner & Pennell, Estate Planning.

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Example 3. If, after the date of the grantor's divorce, the grantor's former spouse borrows the corpus or income from a trust created by the grantor and has not completely repaid the loan before the beginning of the taxable year, the grantor will not be treated as the owner of the trust by reason of § 675(3).

Because similar amendments were not made to other provisions of Subpart E, the operation of which depend on whether a particular individual is the grantor's spouse, it is not clear whether § 672(e)(1)(A) will cause these provisions to continue to apply after the grantor and the grantor's spouse are divorced. To illustrate, consider the following examples:

Example 4. Code § 673 treats the grantor as the owner of any portion of a trust in which the grantor has a reversionary interest in either the corpus or the income if, at the time of the transfer to the trust, the reversionary interest has a value exceeding 5% of the value of the portion that may revert. Because of § 672(e)(1)(A), if the grantor's spouse has a remainder interest in the trust that exceeds 5% of the value of the trust at the time of the transfer to the trust the grantor will be treated as the owner of the trust.⁸ Will grantor trust status continue if the grantor and the grantor's spouse are divorced?

Example 5. Code §§ 674(a), 675(1) and (2), 676(a), and 677(a) treat the grantor as the owner of any portion of a trust if the grantor or a non-adverse party (or both) have a certain power described in the section. Because of § 672(e)(1)(A), a power described in each of these sections held by the grantor's spouse will trigger grantor trust status whether or not the grantor's spouse has an adverse interest. Will this status continue if the grantor and the grantor's spouse are divorced?

Example 6. Code § 674(b)(3), (c), and (d) contain exceptions to the rule creating grantor trust status when nonadverse parties hold a power to alter the beneficial enjoyment of trust property. These exceptions apply for certain powers held by persons other than the grantor. Because of § 672(e)(1)(A), a power held by the grantor's spouse described in one of these sections will be treated as held by the grantor. Will this status continue if the grantor and the grantor's spouse are divorced? In the case of § 674(c) and (d), explicit language limiting the exception to "periods during which the individual is a spouse of the grantor" or periods when the individual is living with the grantor suggest that the spousal unity rule should not apply.

Example 7. Code § 677 treats the grantor of a trust as its owner if the grantor or any person other than an adverse party has the power to distribute income to or accumulate income for future distribution to the grantor or the grantor's spouse. Similarly, § 676 treats the grantor

⁸ In his treatise, *Federal Income Taxation of Estates, Trusts, and Beneficiaries*, Professor Mark L. Ascher notes that § 672(e) was enacted in 1986 to curtail the use of "spousal remainder trusts." A spousal remainder trust pays trust income to a beneficiary (e.g., the grantor's child) for a term of years and, at the end of the term, the remainder passes to the grantor's spouse. Prior to 1986, the trust's income was taxed to the beneficiary because the trust was not treated as a grantor trust under Subpart E, because the grantor did not hold a reversion in the trust. The General Explanation of the 1986 Act provides: "In addition, many tax practitioners took the position that the application of the prior law grantor trust provisions could be avoided by having the prohibited powers or interests become effective in the spouse of the grantor (e.g., the spousal remainder trust)."

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of a trust as its owner if the grantor or any person other than an adverse party has the power to revest title to trust property in the grantor. If the possibility that trust income might be distributed to an individual or that title to trust property might be revested in that individual is treated as an interest in the trust, § 672(e) could cause a trust the income or principal of which is payable or potentially payable to a grantor's former spouse to be treated as owned by the grantor if the grantor was married to the former spouse at any time that the power existed.

IMPACT OF THE REPEAL OF CODE § 682

The repeal of § 682 exacerbates existing problems with the other provisions of Subpart E that apply when a grantor's former spouse has an interest in the trust. The application of § 682 to trusts that make payments to their grantors' former spouses eliminated much of the need to determine whether § 672(e) continues to apply to a grantor's spouse after a divorce by protecting the grantor from gross income inclusion when trust income was payable to a former spouse.

Section 682, in effect, overrode the grantor trust rules in Subpart E of Subchapter J (§§ 671-679) and established different rules for the treatment of distributions from grantor trusts to the grantor's former spouse that some believe might have been taxed to the grantor under §§ 676 or 677 because of the application of § 672(e)(1)(A).⁹ The primary focus of these comments is on the interplay of those provisions. The repeal of § 682 highlights the importance of clarifying the consequences of a grantor's divorce or legal separation for purposes of applying these provisions of the grantor trust rules under Subpart E of Subchapter J.

The repeal of § 682 will have no effect on the impact of most of the provisions referred to above. This is true because § 682 operated only to shift the taxability of income payable to a former spouse from the grantor to the former spouse. It did not stop the operation of the grantor trust rules. For example, the repeal will have no effect on the application of the grantor trust rules to the extent grantor trust status is caused by the mere existence of a power held by a spouse or former spouse.

RECOMMENDATIONS

Code § 672(e). We recommend that Treasury and the IRS address the question of whether the spousal unity rule ends upon the grantor's divorce. We believe that the ambiguity in the current law gives Treasury and the IRS the authority to promulgate regulations clarifying the scope of § 672(e). We also believe the ambiguity should be resolved in favor of terminating the application of § 672(e) once the spousal relationship has been terminated by decree of divorce or legal separation or by the execution of a separation agreement. The spousal unity rule is presumably based on a belief that spouses form a single economic unit. When the end of the marriage separates the unit there is no longer a reason for the rule to apply.

If Treasury and the IRS conclude that they do not have the authority to prevent the application of the spousal unity rule to taxpayers who are no longer married to each other, we recommend that they issue regulations that prevent it from applying to those provisions in Subpart E that are affected by the repeal of § 682. The sections affected by repeal of § 682 are §§ 676 and 677,

⁹ Technically, § 682 does not terminate grantor trust status. It simply provides an exception from ordinary grantor trust treatment for distributions to former spouses.

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because these sections treat a trust as a grantor trust when distributions of trust income or principal must or may be made to the grantor's spouse. We also recommend the issuance of regulations that provide that the internal rules within §§ 674(c) and 674(d), dealing with the consequences of powers held by spouses, should override § 672(e).

Code § 674 (c) and (d). Code § 674(a) provides that the grantor will be treated as the owner of a portion of a trust if the beneficial enjoyment of that portion is subject to a power exercisable by the grantor or a nonadverse party without the consent of an adverse party. Application of the spousal unity rule to § 674(a) causes grantor trust status, because of the existence of the marital relationship, in any situation in which the grantor's spouse holds any powers that the grantor could not hold without causing grantor trust status. There are several exceptions in § 674 to the application of the rule to powers when their exercise does not require the consent of an adverse party. Code § 674(d) is one of the exceptions.

Code § 674(d) provides that § 674(a) does not apply to a power solely exercisable (without the approval or consent of any other person) by a trustee or trustees, none of whom is the grantor or a "spouse living with the grantor," to distribute, apportion, or accumulate income: (a) to or for a beneficiary or beneficiaries, or (b) to, for, or within a class of beneficiaries, if such power is limited in either case by a reasonably definite external standard that is set forth in the trust instrument. Whether this exception is applicable when a former spouse continues to hold a power held during marriage is unclear. The text of the provision suggests that it should not apply, at least if the grantor and the grantor's spouse are not living together. On the other hand, to some § 672(e) seems to operate without regard to present marital status by imputing any power held by a former spouse who held a power during marriage to the grantor. The apparent conflict between the text of §§ 674(d) and 672(e) creates an ambiguity that could be resolved by regulation. We recommend the issuance of a regulation that resolves the ambiguity by providing that a power held by a former spouse will not be imputed to the grantor for purposes of the § 674(d) exception.

Similarly, § 674(c) provides that § 674(a) does not apply to a power held by certain persons, none of whom is the grantor. It further provides that for periods during which an individual is the spouse of the grantor, within the meaning of § 672(e)(2), a reference to the grantor is to be treated as a reference to the spouse. Section 672(e)(2) provides that an individual legally separated from his spouse under a decree of divorce or separate maintenance shall not be considered as married. Whether the § 674(c) exception is applicable when a former spouse continues to hold a power held during marriage is unclear. We recommend the issuance of a regulation that resolves this ambiguity by providing that a power held by a former spouse will not be imputed to the grantor for purposes of the § 674(c) exception.

Code § 677. Code § 677(a) originally provided that the grantor would be treated as the owner of any portion of a trust if the income from that portion may, without the consent of an adverse party, be distributed to or accumulated for future distribution to the grantor.

Code § 677(a) was amended in 1969 to provide that a grantor is also treated as the owner of any portion of a trust if income from the trust may be distributed to the grantor's spouse, or accumulated for future distribution to the grantor's spouse. This provision was described by the Staff of the Joint Committee on Taxation in its general explanation as follows:

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The Act further provides that in the case of a trust created by a taxpayer for the benefit of his spouse, the trust income which may be used for the benefit of the spouse is to be taxed to the creator of the trust as it is earned. However, this provision does not apply where another provision of the Code requires the wife to include in her gross income the income from a trust.¹⁰

The Treasury regulations under § 677, which are consistent with the Joint Committee Staff explanation, state that § 677(a) affects income payable to the grantor's spouse "solely during the period of the marriage of the grantor to a beneficiary." Treas. Reg. § 1.677(a)-1(b)(2).¹¹

Treas. Reg. § 1.677(a)-1(b)(2) was promulgated 15 years prior to the enactment of § 672(e)¹² and Congress would have been aware of these regulations in 1985 and 1988. If § 672(e) is deemed to have overruled this regulation, then the repeal of § 682 is likely to have serious and often unexpected consequences to divorced taxpayers who created trusts during their marriages for the benefit of now former spouses.

Moreover, § 672(e) is applicable only if the grantor's spouse holds an interest in or a power over a trust. In contrast, the operation of § 677 depends not on the possession of an interest or power by the grantor's spouse, but on the existence of another person's power to make distributions to the spouse. It is not clear, therefore, that § 672(e) was intended to apply for purposes of § 677. We recommend the issuance of a regulation that clarifies the scope of § 672(e) by providing that it does not apply for purposes of § 677. Instead, the continued application of the existing regulations under § 677, which limit its application to income payable to the grantor's spouse during the marriage, should be confirmed.¹³

Code § 676. Code § 676 provides that the grantor of a trust will be treated as the owner of any portion of a trust if the grantor or a nonadverse party has the power to revest title to that portion of the trust in the grantor.

If, during the grantor's marriage, the grantor's spouse acquired the power to revest title to a portion of the trust in the grantor, § 672(e) should apply to cause the trust to be treated as a grantor trust. Moreover, after divorce, if the former spouse continues to have this power, the trust should be treated as a grantor trust *unless* the former spouse has an interest in the trust that is adverse to his

¹⁰ JCS-16-70 at page 119.

¹¹ Treas. Reg. § 1.677(a)-1(b)(2) also provides "[i]n the case of divorce or separation, see sections 71 and 682 and the regulations thereunder." This is merely a cross reference and does not mandate treatment under the Treasury regulation as being contingent on the continued application of §§ 71 and 682.

¹² T.D. 7148, 36 FR 20749, Oct. 29, 1971, as amended by T.D. 8668.

¹³ If this recommendation is accepted, we also recommend a change to Example 10 in Treas. Reg. § 1.1361-1(k)(1). This example, which affects the eligibility of a trust for qualified subchapter S trust treatment, focuses on whether a trust created during a grantor's marriage that was treated as a grantor trust under section 677 because of required payments to the grantor's spouse will continue to be treated as a grantor trust after the grantor and the spouse are divorced. The example concludes that "[u]nder section 682, A ceases to be treated as the owner of the trust under section 677(a) because A and B are no longer husband and wife." The conclusion that the trust is no longer a grantor trust should be the same, but the basis of the conclusion should be the regulations under § 677 rather than the operation of § 682.

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or her exercise of the power. We recommend the issuance of a regulation that confirms this conclusion.

As is the case with § 677, the operation of § 676 depends on the existence of another person's power to make trust distributions to the grantor or the grantor's spouse, not on the actual possession of any power or interest by the grantor or the grantor's spouse. Section 677's focus is on the power to distribute income while § 676's focus seems to be on the power to distribute the trust's original principal. Although an individual in whose favor a trustee can exercise such a power could be viewed as holding an interest in the trust, if this kind of power is treated as conferring an interest on the spouse for purposes of § 672(e), § 672(e) could cause § 676 to apply to a grantor because of a power of invasion exercisable in favor of a former spouse. After the repeal of § 682, trust income paid to the former spouse of a grantor would be taxed to the grantor. We believe it unlikely that this result was intended after the economic unity of the spouses is terminated with the termination of the marriage. We recommend the issuance of a regulation under § 672(e) that provides either (1) that a power held by a nonadverse party to transfer trust property to a spouse or former spouse of the grantor should not be treated as conferring the kind of *interest* in the trust that § 672(e) was intended to reach or (2) that § 672(e) does not apply to a § 676 spousal interest after the grantor and the grantor's spouse are no longer spouses within the meaning of § 672(e)(2).

CONCLUSION

ACTEC appreciates your consideration of these Comments in response to Notice 2018-37. ACTEC would be pleased to answer any questions and to work with the drafters in developing solutions to the issues raised in these Comments.

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American Bar Association Section of Family Law Report to House of Delegates Resolution 102A (Adopted August 6-7, 2018 at the 2018 Annual Meeting in Chicago)

102A

ADOPTED

AMERICAN BAR ASSOCIATION

SECTION OF FAMILY LAW

REPORT TO THE HOUSE OF DELEGATES

RESOLUTION

1 RESOLVED, That the American Bar Association urges Congress to enact former Sections 215
2 and 682 of the Internal Revenue Code that, before their repeal in the Tax Cuts and Jobs Act of
3 2017 allowed payors to deduct and required payees to treat as taxable income alimony payments.
4
5 FURTHER RESOLVED, That, if Congress does not reinstate the alimony deduction and section
6 682 of the Internal Revenue Code, the American Bar Association urges all federal, state,
7 territorial and tribal governments to enact laws protecting the reasonable expectations of
8 taxpayers with respect to agreements and arrangements entered into prior to the effective date of
9 said repeal, including but not limited to pre-nuptial agreements, post-nuptial agreements, trusts
10 and similar arrangements, but only to the extent that income is not attributable to corpus added to
11 a trust after the effective date of on which the Tax Cuts and Jobs Act of 2017 became effective.

REPORT

I. INTRODUCTION AND SUMMARY

Among the many tax deductions that the Tax Cuts and Jobs Act eliminated from the Internal Revenue Code was the deduction for alimony payments. This deduction is not a deduction like others that eliminates the payment of tax on income. Rather, this deduction shifts the tax obligation to the individual who has the benefit of spending the income. In promoting the 2017 Tax Act, the Joint Committee on Taxation characterized the alimony deduction as a “divorce subsidy” which gives an advantage to divorced couples over married couples and projected that the elimination of the alimony deduction will increase tax revenues by \$8.3 billion over 10 years.¹ Even if true, this savings should not be funded at the expense of divorcing families whose financial conditions are most often changing for the worse. The 2017 Tax Cuts and Jobs Act was signed into law on December 22, 2017. The elimination of the alimony deduction applies to:

(1) any divorce or separation instrument (as defined in section 71(b)(2) of the Internal Revenue Code of 1986 as in effect before the date of the enactment of this Act) executed after December 31, 2018, and

(2) any divorce or separation instrument (as so defined) executed on or before such date and modified after such date if the modification expressly provides that the amendments made by this section apply to such modification.

This Resolution asks Congress to reinstate the alimony deduction available to payors of alimony. Eliminating the deduction will make court proceedings more costly and time consuming as many states which currently use gross income to calculate alimony awards will now have to determine net income to calculate alimony awards. Further, divorcing couples will receive less favorable tax benefits than married couples. Without the alimony deduction, alimony paying spouses will pay taxes on money they do not get to spend at a higher tax rate and without many of the deductions available to married couples. As a result, the same gross income that was available during the marriage to support one household will be taxed at a higher rate leaving less net income to allocate between two households. Finally, the elimination of the alimony deduction will negatively affect couples who entered into prenuptial agreements with alimony provisions based on the assumption that the alimony deduction would be available. Because prenuptial agreements do not qualify as “divorce or separation instruments,” if the couple divorces after December 31, 2018, the party who agreed to pay alimony on the assumption that it would be tax deductible will now be required to pay the amount agreed upon without that benefit and the party receiving the alimony will receive a windfall.

The 2017 Tax Act also repealed section 682 of the Tax Code which provided rules regarding the tax treatment of income of alimony trusts payable to a former spouse. Section 682(a)

¹ Joint Committee on Taxation, *Description of the Chairman’s Mark of the “Tax Cuts and Jobs Act”* (JCX-51-17) (2017).

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provides that the donee spouse is to include the gross income actually received rather than requiring the donor spouse to include the gross income. With the repeal of section 682, parties that set up such alimony trusts prior to December 31, 2018 but who are not divorced or legally separated until after December 31, 2018 will lose the anticipated tax treatment.

II. BACKGROUND

In a divorce situation, alimony payments are often based upon one party's need and the other party's ability to pay or on the disparity in the parties' incomes. It is well recognized that it is more expensive for families to support two households after a divorce. The alimony deduction has been part of the Internal Revenue Code for the last seventy-five years.² The Internal Revenue Code includes alimony and separate maintenance receipts in the definition of "Gross Income."³ The Internal Revenue Code defines "alimony or separate maintenance payments" as follows:

- (1) **In general.** The term "alimony or separate maintenance payment" means any payment in cash if—
- (A) such payment is received by (or on behalf of) a spouse under a divorce or separation instrument,
 - (B) the divorce or separation instrument does not designate such payment as a payment which is not includible in gross income under this section and not allowable as a deduction under section 215,
 - (C) in the case of an individual legally separated from his spouse under a decree of divorce or of separate maintenance, the payee spouse and the payor spouse are not members of the same household at the time such payment is made, and
 - (D) there is no liability to make any such payment for any period after the death of the payee spouse and there is no liability to make any payment (in cash or property) as a substitute for such payments after the death of the payee spouse.⁴

Before its repeal Section 215 provided:

In the case of an individual, there shall be allowed as a deduction an amount equal to the alimony or separate maintenance payments paid during such individual's taxable year.⁵

The change is effective for any divorce or separation agreements or court orders entered into after December 31, 2018 and for any divorce or separation agreements or court orders entered into before December 31, 2018 that are modified after December 31, 2018. A party paying alimony will no longer receive a deduction and the party receiving alimony will no longer have to

² 26 U.S.C. §§ 1-1564 (1986). The 1986 Act continued the deduction first established in 1942.

³ 26 U.S.C. § 61(a)(8).

⁴ 26 U.S.C. § 71(b).

⁵ 26 U.S.C. § 215(a).

report it as income. When the bill was introduced in the House, the House Ways and Means Committee claimed that the “intent of the proposal was to follow the rule of the Supreme Court’s holding in *Gould v. Gould*⁶, in which the Court held that such payments are not taxable income to the recipient.”⁷ The *Gould* decision was based upon the Income Tax Act of October 3, 1913, long before the current law.

III. PURPOSE OF THE RESOLUTION

The purpose of this Resolution is to urge Congress again enact the alimony deduction. Over the last seventy-five years, the ability to deduct alimony payments has made paying alimony more palatable to the higher income spouse, has enabled divorcing couples to continue to share income as they did during marriage and has done so in a manner that makes calculations easy for the parties without the expense of having attorneys, experts and the court perform complicated net income calculations.

The other purpose of this Resolution is to urge Congress to enact legislation to protect the expectation of taxpayers who entered into agreements to create Section 682 Trusts in the event of a divorce. If such legislation is not enacted, couples who have a 682 Trust agreement in place but who do not divorce before December 31, 2018 will lose the anticipated ability to transfer tax liability to the spouse receiving the payment and the grantor spouse will be required to pay tax on all trust income. As a result, the grantor spouse will have a higher tax burden and beneficiary spouse will receive non-taxable funds.

IV. THE IMPORTANCE OF THE ALIMONY DEDUCTION

The alimony deduction has been an important tool for family law attorneys since 1942 and has enabled divorced families to easily calculate alimony agreements without the necessity of lengthy and expensive court proceedings involving experts to calculate net incomes of the parties. Allowing the higher income spouse to make payments based on gross income by shifting part of the tax liability on his/her income to the lower income spouse enables the divorcing couple to share the same income they had to support one household during the marriage in a way that results in the ability to provide for the two households. Further, unlike other tax deductions, the alimony deduction is not one that results in no revenue to the federal government. Rather, the alimony deduction shifts the tax obligation to the party who actually receives the funds. Without the alimony tax deduction, divorced spouses will be unable to continue to share the same income that was available in the household during the marriage and the higher income spouse will not be able to pay alimony at a rate that will enable the lower income spouse to support his/her own household.

Currently, in most cases, after a divorce, the spouse paying the alimony is in a considerably higher tax bracket than spouse receiving the money. The difference between these tax brackets provides a benefit to the spouse paying the alimony and an even

⁶ 245 U.S. 151 (1917).

⁷ Committee on Ways and Means, *Tax Cuts and Jobs Act, H.R. 1: Section-by-Section Summary*, at 61 (2017).

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greater benefit to the one receiving it. Essentially, the spouse receiving alimony is getting considerably more in actual dollars than the spouse paying it.⁸

Thus, many family law attorneys view the elimination of the alimony tax deduction as a “divorce penalty,” not a “divorce subsidy.”

If alimony is no longer deductible, the ability of an ex-spouse to pay it may be limited, due to other fixed expenses, such as child support payments, and education expenses for children. There is only so much juice that can be squeezed from the orange.⁹

Additionally, many states use gross income to determine a party’s alimony obligation because the party receiving alimony will be paying the taxes on the funds. Being able to calculate a party’s alimony obligation based on gross income is easier for the courts and results in less frequent modifications due to fluctuating tax deductions from year to year. The elimination of the alimony deduction will require many states to formulate a new methodology for determining alimony and will likely cause parties to file modification requests more frequently as their tax obligations change.

There is a concern among the family law bar that the elimination of the alimony deduction will result in fewer settlements, higher litigation costs and lower support orders for the dependent spouse as the parties will now be sharing less net income between two households. Divorcing couples will have greater tax obligations than married couples on the same amount of gross income. There is also concern that the elimination of the alimony deduction will cause some unhappy couples or couples where domestic violence or other abuses exist to remain married because they will simply be unable to afford to get divorced.

Family lawyers are also concerned that the repeal of the alimony deduction has overlooked couples who have entered into prenuptial agreements with alimony provisions on the assumption that the alimony deduction will be available. Since the Internal Revenue Code’s definition of “divorce or separation instrument” does not include a prenuptial agreement that is not in pay status, if the couple divorces after December 31, 2018, the party who agreed to pay alimony will no longer be able to deduct the payments. Rather, the party paying alimony will have to pay the agreed upon amount without being able to deduct the payments and the party receiving alimony will receive an unanticipated windfall by not having to pay taxes on the payments. This unanticipated consequence could lead to more court proceedings in seeking to modify or enforce such prenuptial agreements.

⁸ Malcom S. Taub, *How Tax Reform Could Radically Change Divorce*, Forbes (Nov. 9, 2017), <https://www.forbes.com/sites/nextavenue/2017/11/09/how-tax-reform-could-radically-change-divorce/#6fdac6e74e02>.

⁹ *Id.*

V. THE IMPORTANCE OF IRC SECTION 682

The effect of the repeal of IRC Section 682 is addressed in the attached Tax Section Report on Alimony Transitional Guidance. As noted therein, before its repeal, Section 682 allowed the grantor spouse to transfer separate property to a trust for the benefit of the other spouse. Upon divorce, the beneficiary spouse would receive the income from the trust for a certain term and pay the taxes on the income received. The principal would eventually revert back to the grantor spouse.

The 2017 Tax Act did not grandfather in Section 682 Trusts and agreements to create 682 trusts in the event of a divorce that are not yet in pay status. Thus, couples who divorce after December 31, 2018 will not receive the benefit of their bargain. Rather, the grantor spouse who agreed to place certain assets into trust with the expectation of transferring the tax liability for the payments made by the trust will now have to pay the taxes. If the beneficiary spouse is not willing to renegotiate changes to the trust or if the trust is irrevocable, the divorcing couples may experience further stress and additional litigation costs.

VI. CONCLUSION

This Resolution urges Congress to consider the detrimental effects on the family court system and divorced families caused by eliminating the alimony deduction and to reinstate the alimony deduction. This Resolution also urges Congress to reinstate former Section 682 of the Internal Revenue Code, as its elimination will have unintended consequences for parties who established alimony trusts prior to December 31, 2018, but who are not yet divorced or legally separated.

VII. Alimony Transitional Guidance

Background On The Alternative Resolution

Prior to its repeal in the Tax Cut And Jobs Act of 2017 (TCJA), the alimony deduction, as codified by Internal Revenue Code (IRC) Section 71, was one of the longest-standing deductions available to individual taxpayers. A part of the income tax law for roughly 75 years, the alimony deduction predates the first modern income tax code. For many taxpayers, the alimony deduction was treated as an immutable fact upon which to base planning for future divorce contingencies. The revocation of the alimony deduction puts many taxpayers who incorporated the alimony deduction into their post marital planning in a difficult position. These taxpayers have pre-existing, binding agreements that will lose their intended economic effect if the taxpayer divorces after 2018.

Restoring the alimony deduction, as requested by the ABA Family Law Section in Resolution 115A would eliminate the issues addressed below. Should Congress not restore the alimony deduction, this report is intended to: 1) identify issues that should be addressed by separate legislation, or if appropriate, rule-making; and 2) provide recommendations on how to correct some of the most serious problems arising from the repeal of the alimony deduction.

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Current State Of The Law

The alimony deduction allows the payor of alimony, as specifically defined, to take a deduction from income for amounts paid to a former spouse. The recipient of the alimony then includes the payment as income and pays tax on the amounts received. As long as both the payor and the recipient include the same amount as deductible and as income, 100% of the income is reported to the IRS. Each party is then responsible for calculating and paying the correct amount of tax based upon their individual situation. Given the recipient of the alimony often has a lower marginal rate than the person paying the alimony, the deduction frequently reduces the combined overall tax burden of the former spouses.¹⁰

The TCJA repealed the alimony deduction for couples divorcing after 2018. Couples that are divorced, or finalize their divorce, prior to the end of 2018, may apply pre-TCJA law and will be able to claim the alimony deduction. Those couples that divorce in 2019 or later will no longer be able to claim the alimony deduction. Absent the alimony deduction, all income is taxed to the person who earned the income regardless of what obligations they may have to pay support to a former spouse.

Guiding Principles Of The Report

This report is not intended to be an exhaustive list of potential future problems associated with the repeal of the §71 alimony deduction. It is intended to be narrowly construed and only seeks to comment on issues that are of importance to the integrity of tax administration, which seeks to provide consistent tax treatment of similarly situated taxpayers. The repeal of the alimony deduction has created two categories of taxpayers who may face different and unequal treatment under the new law because it grandfathered in certain taxpayers into the current alimony rules but excludes others. These two categories of excluded taxpayers are:

1. Taxpayers who entered into binding contracts through pre and post nuptial agreements, prior to the repeal of the alimony deduction, under which they are obligated to make alimony payments.
2. Taxpayers who entered into binding contracts to create, or have previously created, trusts that pay support similar to alimony and which prior to 2019, would result in the payments from the trust being income to the beneficiary rather than the grantor under IRC Section 682.

Importance Of Equal Treatment

The issues selected for this report were selected because the repeal of the alimony deduction changed the economic effect of previously agreed to contracts. Other similar contracts, such as privately negotiated divorce settlements entered into prior to 2019, were allowed to maintain the bargained-for economic effect. This creates a system where two contracts, both made before the effective date of TCJA, that both made the same assumptions about the future deductibility of alimony payments, and both provided for the same alimony payments, nonetheless have two different tax treatments under TCJA.

¹⁰Many scholars view alimony payments as payments made for the value of gains made by the marital unit during the length of marriage. Under this gain theory of alimony these payments represent ongoing property divisions from current income rather than true “deductions” which are normally tied to expenses for the production of income.

It is important to note how similar these types of private contracts are to divorce decrees or separation agreements. Taxpayers who enter into an agreement in contemplation of divorce have the same type of representation as those taxpayers who enter into settlement after a couple has filed for divorce. In both circumstances, each party is represented by a family law attorney, each has access to the other party's financial information, and both use similar information to calculate support payments.

Pre and Post Nuptial Agreements

Pre and postnuptial agreements are binding agreements made between individuals that are enforceable under state law. As these agreements specify what should happen in the event of a future divorce, they require the parties and their counsel to make assumptions about what the future will hold. Every agreement that specifies support after the termination of the marriage, either by the application of an earnings formula or a specified dollar amount, is implicitly based upon the assumption that alimony would be deductible by the payor.

TCJA grandfathered payments structured under a pre-2019 divorce decree, allowing application of the alimony deduction. However, pre and postnuptial agreements entered into prior to 2019 are not grandfathered under the legislation. This causes a number of problems for currently married couples who entered into these agreements. First, if a couple with a prenuptial agreement, even a 20 year old prenuptial agreement, divorces after 2019, the economic effect of the agreement has been altered. The payor will likely end up with a larger tax burden than anticipated, while the recipient will receive tax-exempt payments.

Fixing these economic distortions is not as simple as saying the agreement should be renegotiated. Even under the best of circumstances, renegotiating the agreement would cause familial stress. Each side would likely incur additional legal fees and in many cases the renegotiation would fail. It is likely that in many circumstances the recipient of the alimony would refuse to renegotiate if the recalculated alimony amount would be reduced because that would be against their interests. It is also likely that there would be an increased volume in contests to the validity of the agreement based on the change in the law. This could lead to litigation and uncertainty, which is what pre and post nuptial agreements are intended to avoid.

Trust Payments Pursuant To A Divorce - Irc Section 682

Prior to its repeal by the Tax Cut and Jobs Act of 2017, Section 682 provided that income from a trust established by a grantor as part of a divorce decree or a separation agreement was properly taxable to the designated beneficiary, rather than the grantor of the trust. Section 682 allowed a spouse with substantial separate property to transfer a principal amount to a trust. In the event of a divorce, or pursuant to a preexisting plan or agreement, the income from the property held by the trust would be payable to the former spouse for a certain term, after which the property, or the income from the property would revert back to the grantor.

The advantage of a Section 682 trust was that it reduced some of the uncertainties for each party. The contributing party was assured that the principal would not be at risk. The recipient of

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the income would be assured of steady stream of income from assets that could not be squandered or transferred beyond their reach, and each party could rely on a professional to manage the assets of the trust so that the assets would generate a commercially reasonable rate of return.

Like pre/post nuptial agreements, existing Section 682 trusts and agreements to create Section 682 trusts in the event of a divorce, are not grandfathered into the alimony deduction under TCJA. If a couple has a valid Section 682 trust agreement in place and does not divorce before 2019, the trust will be treated under the general grantor trust rules, which essentially treat the grantor as the taxpayer. The grantor would be responsible for paying tax on all of the income from the trust assets, including amounts legally required to be transferred to the former spouse.

The economic distortion caused by the repeal of the alimony deduction on Section 682 trusts is twofold. First, the grantor will have a higher tax burden and the beneficiary will receive non taxable distributions. Second, if the agreement only specified a set amount of principal to be transferred to the trust because the negotiations assumed, but the documents did not incorporate in a support formula with an assumed rate of a return and the beneficiary's tax rate on that income, the amount of principal contributed may be higher than needed to achieve the desired agreed upon result.¹¹

Curing these economic distortions may not always be possible. In some cases, Section 682 trusts are irrevocable trusts. As an irrevocable trust, it may be impossible for the settlor or the beneficiary to modify the terms of the trust so that it complies with the couple's original intentions. As with prenuptial agreements, the beneficiary spouse may be unwilling to negotiate any changes, and any negotiations regardless of success will take resources and cause family stress.

Solution To TCJA Created Consequences For Pre-2019 Marital Agreements And Trusts

Payments under binding agreements such as prenuptial agreements and Section 682 trusts entered into before 2019 should be given the same tax treatment as payments pursuant to divorce decrees entered into before 2019. In both situations, the payor should receive a deduction and the payee should pay tax on the amount that would be considered alimony under the pre-2019 rules.

Granting binding agreements the same protections as divorce decrees is good tax policy. Pre and post nuptial agreements as well as Section 682 trusts are not substantially different from the agreement that currently are grandfathered into the existing alimony deduction. As binding agreements, the parties should be able to enjoy the economic effect that they agreed to when entering the contract. Grandfathering these agreements into the alimony deduction creates certainty for the parties involved. Furthermore, the proposed grandfathering saves taxpayers time, resources, and marital stress by not forcing them to attempt to renegotiate old agreements.

¹¹ A simple support formula may be $\text{Annual Support} = (\text{Principal} \times \text{rate of return}) - \text{Beneficiary's tax rate}$. The document may simply solve for Principal to avoid the grantor being responsible for a lower than expected rate of return due to market conditions.

Administration Of Proposed Solution

From an administrative standpoint, proving the existence of a pre-2019 agreement does not require significant resources. Any agreement which would be grandfathered into the current alimony rules is a written agreement which is dated and signed by the parties. In the event of an audit, a revenue agent can simply request a copy of the document and verify the date on which the parties signed the agreement. If there is a question of authenticity there are other parties which can verify the date of the agreement. Overall, it is a small burden for the IRS when compared to the significant impact on affected taxpayers.

Conclusion

Good tax administration should strive to treat all similarly situated taxpayers the same way. The way the repeal of the alimony deduction was drafted does not accomplish this goal. The law as written grandfathers in some taxpayers into the current alimony system while depriving other similarly situated taxpayers the same benefit. In order to treat all similarly situated taxpayers the same, Congress should pass legislation that extends the alimony deduction to all taxpayers who entered into binding agreements prior to the repeal date.

Respectfully submitted,

Roberta S. Batley
Chair, Family Law Section

Dated: August 2018

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GENERAL INFORMATION FORM

Submitting Entity: ABA Section of Family Law
Submitted By: Bobbie Batley, Chair, ABA Section of Family Law

1. Summary of Resolution(s). The Resolution urges Congress to reinstate the tax deduction for alimony payments.
2. Approval by Submitting Entity. The ABA Section of Family Law approved submission of this Resolution on June 4, 2018.
3. Has this or a similar resolution been submitted to the House or Board previously? Yes, it was submitted for the Midyear 2018 Meeting of the House of Delegates, but was withdrawn prior to February 5.
4. What existing Association policies are relevant to this Resolution and how would they be affected by its adoption? There is no ABA policy on this subject so no existing policy would be adversely affected by this Resolution. This resolution strives to give divorcing individuals equal treatment to other taxpayers and is in harmony with other ABA policy designed to ensure equal protection.
5. If this is a late report, what urgency exists which requires action at this meeting of the House? Not Applicable.
6. Status of Legislation. The Resolution urges enactment of tax code sections previously repealed in on December 22, 2017, but there is no pending legislation.
7. Brief explanation regarding plans for implementation of the policy, if adopted by the House of Delegates. Submission to the Congress.
8. Cost to the Association. (Both direct and indirect costs). None.
9. Disclosure of Interest. (If applicable). Not Applicable.
10. Referrals.

Section of Taxation
Real Property, Trust and Estate Law Section
Business Law Section
Litigation Section
Dispute Resolution Section
Solo, Small Firm and General Practice Division
Young Lawyers Division
Senior Lawyers Division

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11. Contact Name and Address Information. (Prior to the meeting. Please include name, address, telephone number and e-mail address).

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12. Contact Name and Address Information. (Who will present the report to the House? Please include name, address, telephone number, cell phone number and e-mail address.)

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EXECUTIVE SUMMARY

1. Summary of the Resolution
The Resolution urges Congress to reinstate the tax deduction for alimony payments.
2. Summary of the Issue that the Resolution Addresses
Alimony is often relied upon to provide ongoing financial support to the lower income spouse following a divorce. The alimony deduction helps enable divorced families to support two households on the same income that married couples use to support one household by shifting the income to the spouse in a lower tax bracket. Without the alimony deduction, there will be a larger portion of the income going to the government and a smaller portion of the income allocated between two households. Elimination of the alimony deduction from the new tax code may have a chilling effect on divorce settlements; may result in lower alimony awards; and may have a negative effect on divorced families. .
3. Please Explain How the Proposed Policy Position will address the issue
This Resolution urges Congress to enact anew provisions providing for an alimony deduction. It similarly urges Congress to reinstateSection 682 of the Internal Revenue Code, with similar effect on the taxability of alimony trusts.
4. Summary of Minority Views
None.

EXHIBIT 5

Dennis and Debbie – Tenants by the Entireties Plan

DEBBIE & DENNIS	Debbie	Dennis	T by E
Upon Debbie's Death House – Protected Homestead			\$3.8 M
Brokerage			\$20 M
TOTAL			\$23.8 M
Debbie's Gross Estate Assuming She Dies First – All Joint Assets			\$11.9 M
MARITAL DEDUCTION			\$11.9 M
Debbie's Taxable Estate			\$0
Debbie's Tax			\$0

DEBBIE & DENNIS	Debbie	Dennis	T by E
UPON DENNIS' DEATH			
Dennis' Gross Estate			\$23.8 M
Less Applicable Exclusion Amount (assuming portability)			\$(22.8 M)
Dennis' Taxable Estate			\$1 M
Dennis' Tax			\$400,000
Assets subject to creditors while both married and living			\$0
Assets subject to creditors upon death of 1 st spouse or dissolution of marriage			\$20 M
Assets benefitting from step up in basis upon death of surviving spouse			\$20 M + homestead

EXHIBIT 6

Dennis and Debbie – CPA’s Tax Savings Plan

DEBBIE & DENNIS	Debbie’s Revocable Trust	Dennis’ Revocable Trust	T by E
Upon Debbie’s Death House – Protected Homestead			\$3.8 M
Brokerage	\$10 M	\$10 M	
TOTAL	\$10 M	\$10 M	\$3.8 M
Debbie’s Gross Estate Assuming She Dies First	\$11.9 M		
Debbie’s Share of Homestead to Dennis Outright	(\$1.9 M)		
MARITAL DEDUCTION	\$1.9 M		
Debbie’s Taxable Estate	\$10 M		
Less Basic Exclusion Amount	(\$10 M)		
Debbie’s Tax	\$0		

DEBBIE & DENNIS	Debbie’s Revocable Trust	Dennis’ Revocable Trust	T by E
UPON DENNIS’ DEATH			
	<u>\$13.8 M</u>		
Dennis’ Gross Estate	Homestead \$3.8 M Brokerage Assets \$10 M		
Less Applicable Exclusion Amount (\$11.4 M plus \$1.4 M of portability)	(\$12.8 M)		
Dennis’ Taxable Estate	\$1 M		
Dennis’ Tax	\$400,000		
Savings Compared to Tenancy by the Entireties	\$0		

Assets subject to creditors

while both married and living	\$20 M
death of 1 st spouse or dissolution of marriage, assuming assets pass into spendthrift trust for surviving spouse upon death of 1 st spouse	\$10 M

Basis step up

death of surviving spouse, no GPA	\$13.8 M + homestead
death of surviving spouse, GPA	\$23.8 M + homestead

EXHIBIT 7

Florida Statute Section 736.0505(1)(a)

736.0505 Creditors' claims against settlor.—

(1) Whether or not the terms of a trust contain a spendthrift provision, the following rules apply:

(a) The property of a revocable trust is subject to the claims of the settlor's creditors during the settlor's lifetime to the extent the property would not otherwise be exempt by law if owned directly by the settlor.

EXHIBIT 8

Dennis and Debbie – Inter Vivos QTIP

DEBBIE & DENNIS	Debbie's QTIP	Dennis' QTIP	T by E
Upon Debbie's Death House – Protected Homestead			\$3.8 M
Brokerage	\$10 M	\$10 M	
TOTAL	\$10 M	\$10 M	\$3.8 M
Debbie's Gross Estate Assuming She Dies First	\$11.9 M		
Debbie's Share of Homestead to Dennis Qualifying for Marital Deduction	(\$1.9 M)		
MARITAL DEDUCTION	\$1.9 M		
Debbie's Taxable Estate	\$10 M		
Less Basic Exclusion Amount	(\$10 M)		
Debbie's Tax	\$0		

DEBBIE & DENNIS	Debbie's QTIP	Dennis' QTIP	T by E
UPON DENNIS' DEATH			
Homestead	\$3.8 M		
QTIP Trust from Debbie	\$0		
Dennis' Gross Estate (includes Dennis' \$10 M QTIP and \$3.8 M Homestead)	\$13.8 M		
Less Applicable Exclusion Amount (Dennis' Basic Exclusion Amount of \$11.4 M plus \$1.4 M of Portability)	(\$12.8 M)		
Dennis' Taxable Estate	\$1 M		
Dennis' Tax	\$400,000		

Assets subject to creditors

while both married and living	\$0
death of 1 st spouse or dissolution of marriage	\$0

Basis step up

death of surviving spouse, no GPA	\$10 M + ½ homestead
death of surviving spouse, GPA	\$10 M + entire homestead

EXHIBIT 9

Summary of states having some type of tenants by the entirety protection (Tenancy by the Entireties Statutes)

State	Statute	Case Law Referencing (if necessary)
Alaska	AS 34.15.140 AS 09.38.100	Debtor spouse's interest is not protected from claims of debtor spouse's creditors
Arkansas		Arkansas allows both real and personal property to be held as tenants by the entirety. A third party may execute against the debtor's spouse's interest in tenancy by the entirety, but the non-debtor spouse still retains the rights of possession, survivorship, and interest and half the rents and profits. <i>Morris v. Solesbee</i> , 892 S.W.2d 281 (Ark. App. Ct. 1995); <i>Lowe v. Morrison</i> , 711 S.W.2d 833 (Ark. 1986); <i>Ford v. Felts</i> , 624 S.W.2d 449 (Ark. Ct. App. 1981) ("Arkansas follows the rule that a homestead may be acquired in land held by a husband and wife as tenants by entireties.")
Delaware		<i>Citizens Sav. Bank, Inc. v. Astrin</i> , 61 A.2d 419, 421 (Del. Super. Ct. 1948) ("...it appears that the only property involved in this litigation is the real estate owned by the bankrupt and his wife as tenants by the entirety. In Delaware, this type of ownership retains most, if not all, of its common law features.") Fred Franke, "Asset Protection and Tenancy by Entirety" 34 ACTEC J 210 (2009)
District of Columbia		<i>Estate of Wall</i> , 142 U.S.App.D.C. 187, 440 F.2d 215 (1971). Under such an estate, there is an inability of one spouse to alienate his interests and there is a broad immunity from separate creditors. Moreover, such an estate can be created in personalty as well as realty. <i>Flaherty v. Columbus</i> , 41 App. D.C. 525 (1914). Language in an instrument which would create a joint tenancy will make a husband and wife owners by the entireties. <i>Settle v. Settle</i> , 56 App.D.C. 50, 51, 8 F.2d 911, 912 (1925). Although tenancy by the entirety has been eliminated in many states, it is still recognized in the District of Columbia. <i>Travis v. Benson</i> , 360 A.2d 506, 509 (D.C. 1976).
Florida	Common Law Florida Statute Section 655.79	<i>Beal Bank v. Almand & Assocs.</i> , 780 So.2d 45 (Fla. 2001).
Hawaii	Haw. Rev. Stat. Section 509-2	A spouse's creditor cannot attach a property held in tenancy by the entirety to satisfy an individual debt. "The tenancy by the entirety is predicated upon the legal unity of husband and wife, and the estate is held by them in single ownership. They do not take by moieties, but both and each are seized of the whole estate." <i>Sawada v. Endo</i> , 57 Haw. 608, 613, 561 P.2d 1291, 1295 (1977) (citation omitted). "The indivisibility of the estate, except by joint action of the spouses, is an indispensable feature of the tenancy by the entirety." <i>Sawada v.</i>

EXHIBIT 9

State	Statute	Case Law Referencing (if necessary)
		<p><i>Endo</i>, 57 Haw. 608, 614, 561 P.2d 1291, 1295–96 (1977) (citation omitted).</p> <p>“A tenancy by the entirety is a unique form of ownership in which both spouses are jointly seized of property such that neither spouse can convey an interest alone nor can one spouse’s creditor attach the property to satisfy a debt.” <i>Traders Travel Int’l, Inc. v. Howser</i>, 69 Haw. 609, 753 P.2d 244 (1988) (citation omitted); see also <i>Sawada v. Endo</i>, 57 Haw. 608, 615, 561 P.2d 1291, 1296</p>
Illinois	750 Ill. Comp. Stat. 65/22	<p>Primary residence held between husband and wife only 765 ILCS 1005/1c Includes TBE in trust: “Where the homestead is held in the name or names of a trustee or trustees of a revocable inter vivos trust or of revocable inter vivos trusts made by the settlors of such trust or trusts who are husband and wife, and the husband and wife are the primary beneficiaries of one or both of the trusts so created, and the deed or deeds conveying title to the homestead to the trustee or trustees of the trust or trusts specifically state that the interests of the husband and wife to the homestead property are to be held as tenants by the entirety, the estate created shall be deemed to be a tenancy by the entirety.”</p> <p>Also, the Illinois Code of Civil Procedure at 735 ILCS 5/12-112, states: “Any real property, or any beneficial interest in a land trust, or any interest in real property held in a revocable inter vivos trust or revocable inter vivos trusts created for estate planning purposes, held in tenancy by the entirety shall not be liable to be sold upon judgment entered on or after October 1, 1990 against only one of the tenants, except if the property was transferred into tenancy by the entirety with the sole intent to avoid the payment of debts existing at the time of the transfer beyond the transferor’s ability to pay those debts as they become due.”</p>
Indiana	Ind. Code Ann. Section 32-17-3-1	<p>Not applicable to debt for which debtor and spouse are jointly liable</p> <p>IC 34-55-10-2(c)(5). Indiana also recognizes “Matrimonial” trusts under IC 30-4-3-35 which allows tenancy by the entireties protection for TBE real estate transferred to revocable trust created by husband or wife when trust and deed contain required matrimonial language.</p>
Kentucky	KY. Rev. Stat. Ann. Section 381.050	<p>If real estate is conveyed or devised to husband and wife, unless a right of survivorship is expressly provided for, there is no mutual right to the entirety by survivorship between them, but they take as tenants in common.</p>
Maryland	MD. Real Prop. Code Ann. Section 4-108	<p>Fred Franke, "Asset Protection and Tenancy by Entirety" 34 ACTEC J 210 (2009) Also T/E Trusts protected E&T § 14.5-511</p>
Massachusetts	Mass. Ann. Laws. Ch. 209 Section 1	<p>A tenancy by the entirety created prior to February 11, 1980 does not receive the full protection of the law. To get the protection, an Election needs to be signed and recorded under Section 1A.</p>
Michigan	MCL 600.2807(1) MCL600.5451(1)(n) if the Michigan bankruptcy exemption is chosen.	<p><i>Butler v. Butler</i>, 332 N.W.2d 488, 490 (Mich. Ct. App. 1983) (“...the common law remains the law of Michigan, stated: "In this State, where the common law is unchanged by statute, a conveyance to husband and wife conveys an estate in entirety, but may create one in joint tenancy or in common, if explicitly so stated in the deed”).</p>

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State	Statute	Case Law Referencing (if necessary)
Mississippi	Miss. Code Ann. Section 89-1-7	Ayers, 417 So.2d at 913-14; Newton, 588 So.2d at 196
Missouri	Common Law MO. Rev. Stat. 442.025	Common law; See also Mo. Ann. Stat. § 456.950 recognizing the existence of tenancy by the entirety property.
New Jersey	N.J. Stat. Ann. Section 46:3-17.4	See <i>Servis v. Dorn</i> , 76 N.J. Eq. 241. Protection until death of one of the parties.
New York	Common Law NY CLS Real Prop. Section 240-b	
North Carolina	N.C. Gen. Stat. Section 39-13.3	Real property owned as tenants by the entirety is not subject to a claim by a creditor against only one spouse. <i>In re Knapp</i> , 285 B.R. 176 (Bankr. M.D.N.C. 2002).
Oklahoma	Okla. Stat. tit. 60 Section 74	
Oregon	Or. Rev. Stat. Section 91.020 Or. Rev. Stat. Section 93.180(1)(b)	<i>Brownley v. Lincoln County</i> , 343 P.2d 529, 531 (Or. 1959) (“We have recognized in this state a form of concurrent ownership in real property by husband and wife which we have denominated a tenancy by the entirety...”).
Pennsylvania	69 PA. Stat. Ann. Section 541	<i>Patwardhan v. Brabant</i> , 439 A.2d 784, 785 (Pa. Super. Ct. 1982)
Rhode Island		<i>Bloomfield v. Brown</i> , 25 A.2d 354, 359 (R.I. 1942) (“The possibility of creating an estate by entirety has not been removed by the married women's act, provided that the intention to create such an estate clearly appears in the conveyance.”).
Tennessee	T.C.A. § 35-15-510 T.C.A. § 66-1-109	Since not vested, a debtor who owned real property jointly with spouse not entitled to homestead. <i>In re Arwood</i> , 289 B.R. 889, (Bankr. E.D. Tenn. 2003). Tenants by entirety only available to married couples. Property held as tenants by entirety exempt from any possessory interest of the separate (not joint) creditors of either spouse. Surviving spouse receives property at death of first spouse free of creditor claims of decedent spouse. <i>Robinson v. Trousdale County</i> , 516 S.W. 2 nd 626, 652 (Tenn. 1974). Since 2014, T.C.A. § 35-15-510 has allowed married couples to create a new form of Joint Revocable Trust where assets held by the Trustee are to have the same immunities from claims of creditors as are provided generally to tenants by the entirety.
Vermont	VT. Stat. Ann. tit. 15 Section 67 Common Law	<i>In re Cerreta</i> , 16 B.R. 402 (1990)

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State	Statute	Case Law Referencing (if necessary)
Virginia	Va. Code § 55-20.2	<p>Applies to real and personal property owned by spouses if expressly held as “tenants by the entirety” or “tenants by the entirety.” Similar protection for former TBE property conveyed by spouses to their joint or separate revocable or irrevocable trusts under certain conditions.</p> <p><i>Rogers v. Rogers</i>, 512 S.E.2d 821, 822 (Va. 1999) (“We have stated, clearly and without equivocation, that real property held as tenants by the entirety is exempt from the claims of creditors who do not have joint judgments against the husband and wife.”).</p>
Wyoming	WYO. STAT. ANN. Section 34-1-140 WYO. STAT. ANN. Section 4-10-402(c)	

EXHIBIT 10

Example of Simple Changes that Could Be Made to Florida Statute Section 736.050(3)

From: Barry Nelson
Sent: Tuesday, September 4, 2018 8:28 AM
To: Cassandra Nelson
Subject: ffi program

I am writing a paper on alternative planning to take advantage of the \$11.18 M Basic Exclusion amounts. One issue is how can we use the current Basic Exclusion amounts by making a current transfer in trust for a spouse, retain access to the funds upon the death or renunciation of the trust by the settlor's spouse and use the Basic Exclusion amount of the of the settlor's spouse without having to wait until the death of the settlor's spouse.

In 2010 Florida Section 736.0505 (3) was added as follows:

(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.

History.—s. 5, ch. 2006-217; s. 5, ch. 2010-122.

I would propose changing the last provision highlighted above to the following

shall, following the termination of the prior interest of the settlor's spouse in such trust, be deemed to have been contributed by the settlor's spouse and not by the settlor. ****

IRS Treas. Reg. §25.2523(f)- 1(f), Example 11 provides that assets held in an inter vivos QTIP trust — for the benefit of the settlor after the death of his or her spouse — will not be includible in the settlor's taxable estate under Code §§2036 and 2038. The proposed change enhances the likelihood that the assets that revert back to a trust for the original settlor as a result of a renunciation (rather than death) of the original donee spouse, will not be includible in the original settlor's estate because under the revised Florida law such assets are considered to be contributed by the settlor's spouse and not by the settlor and accordingly should be free from creditor's claims of the original settlor. This change will provide better support for the position that such assets returning in trust for the original settlor should not be subject to estate tax inclusion. This planning would be more definite as compared to SLAT planning where assets pass upon death or renunciation to the original settlor. Currently there is no Florida Statute reflecting the settlor's spouse is considered the settlor of SLAT assets that pass to the original SLAT settlor and the above mentioned IRS Regulation does not apply because no QTIP election is made. While it is possible that this may also require an amendment to Chapter 739, I do not think one is needed because the definition of disclaimer under 739.102 (5) includes renunciation. As a result, if there is a renunciation that is not a "tax-qualified disclaimer" under 739.501 it would appear the revised statute above would shift the settlor to the person renouncing but maintain the remainder of the Disclaimer statute under Chapter 739 as to succession of asset ownership.

EXHIBIT 11

Comparison of Inter Vivos QTIP Trust Statutes

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Arizona:	Ariz. Rev. Stat. § 14-10505(E)1-4
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A. Whether or not the terms of a trust contain a spendthrift provision, the following rules apply:

1. During the lifetime of the settlor, the property of a revocable trust is subject to claims of the settlor's creditors. If a trust has more than one settlor or contributor, the amount the creditor or assignee of a particular settlor may reach may not exceed the settlor's interest in the portion of the trust attributable to that settlor's contribution. This paragraph does not abrogate otherwise applicable laws relating to community property.

2. Subject to the requirements of this section, with respect to an irrevocable trust, a creditor or assignee of the settlor may reach the maximum amount that can be distributed to or for the settlor's benefit. If a trust has more than one settlor, the amount the creditor or assignee of a particular settlor may reach may not exceed the settlor's interest in the portion of the trust attributable to that settlor's contribution. This paragraph does not apply to any trust from which any distribution to the settlor can be made pursuant to the exercise of a power of appointment held by a third party or abrogate otherwise applicable laws relating to community property. A creditor of a settlor:

(a) Shall not reach any trust property based on a trustee's, trust protector's or third party's power, whether or not discretionary, to pay or reimburse the settlor for any income tax on trust income or trust principal that is payable by the settlor under the law imposing the tax or to pay the tax directly to any taxing authority.

(b) Is not entitled to any payment or reimbursement that is to be made directly to any taxing authority.

(c) Shall not reach or compel distributions to or for the benefit of the beneficiary of a special needs trust.

3. After the death of a settlor, and subject to the settlor's right to direct the source from which liabilities will be paid, the property of a trust that was revocable at the settlor's death is subject to claims of the settlor's creditors, costs of administration of the settlor's estate, the expenses of the settlor's funeral and disposal of remains and statutory allowances to a surviving spouse and children to the extent the settlor's probate estate is inadequate to satisfy those claims, costs, expenses and allowances, except to the extent that state or federal law exempts any property of the trust from these claims, costs, expenses or allowances. If a trust has more than one settlor or contributor, the amount the creditor or assignee of a particular settlor may reach may not exceed the settlor's interest in the portion of the trust attributable to that settlor's contribution. This paragraph does not abrogate otherwise applicable laws relating to community property.

B. For the purposes of this section:

1. During the period the power may be exercised, the holder of a power of withdrawal is treated in the same manner as the settlor of a revocable trust to the extent of the property subject to the power.

2. On the lapse, release or waiver of a power of withdrawal, the holder is not, by reason of any such power of withdrawal, treated as the settlor of the trust.

C. For the purposes of this section, a trust settled or established by a corporation, professional corporation, partnership, limited liability company, governmental entity, trust, foundation or other entity is not deemed to be settled or established by its directors, officers, shareholders, partners, members, managers, employees, beneficiaries or agents.

D. For the purposes of this section, amounts contributed to a trust by a corporation, professional corporation, partnership, limited liability company, governmental entity, trust, foundation or other entity are not deemed to have been contributed by its directors, officers, shareholders, partners, employees, beneficiaries or agents. Powers, duties or responsibilities granted to or reserved by the settlor pursuant to the trust and any actions or omissions taken pursuant to the trust are deemed to be the powers, responsibilities, duties, actions or omissions of the settlor and not those of its directors, officers, shareholders, partners, members, managers, employees, beneficiaries or agents.

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E. For the purposes of this section, amounts and property contributed to the following trusts are not deemed to have been contributed by the settlor, and a person who would otherwise be treated as a settlor or a deemed settlor of the following trusts shall not be treated as a settlor:

- 1. An irrevocable inter vivos marital trust that is treated as qualified terminable interest property under section 2523(f) of the internal revenue code if the settlor is a beneficiary of the trust after the death of the settlor's spouse.**
2. An irrevocable inter vivos marital trust that is treated as a general power of appointment trust under section 2523(e) of the internal revenue code if the settlor is a beneficiary of the trust after the death of the settlor's spouse.
3. An irrevocable inter vivos trust for the settlor's spouse if the settlor is a beneficiary of the trust after the death of the settlor's spouse.
4. An irrevocable trust for the benefit of a person, the settlor of which is the person's spouse, regardless of whether or when the person was the settlor of an irrevocable trust for the benefit of that spouse.
5. An irrevocable trust for the benefit of a person to the extent that the property of the trust was subject to a general power of appointment in another person.

F. For the purposes of subsection E, a person is a beneficiary whether so named under the initial trust instrument or through the exercise by that person's spouse or by another person of a limited or general power of appointment.

G. Subsections C and D do not apply to:

1. A trust that has no valid business purpose and that has as its principal purpose the evasion of the claims of the creditors of the persons or entities listed in those subsections.
2. A trust that would be treated as a grantor trust pursuant to sections 671 through 679 of the internal revenue code. This paragraph does not apply to a qualified subchapter S trust that is treated as a grantor trust solely by application of section 1361(d) of the internal revenue code.

Arkansas: Ark. Code Ann. § 28-73-505(c)
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- (a) Whether or not the terms of a trust contain a spendthrift provision, the following rules apply:
 - (1) During the lifetime of the settlor, the property of a revocable trust is subject to claims of the settlor's creditors. If a trust has more than one (1) settlor, the amount the creditor or assignee of a particular settlor may reach may not exceed the settlor's interest in the portion of the trust attributable to that settlor's contribution.
 - (2) With respect to an irrevocable trust, a creditor or assignee of the settlor may reach the maximum amount that can be distributed to or for the settlor's benefit. If a trust has more than one (1) settlor, the amount the creditor or assignee of a particular settlor may reach may not exceed the settlor's interest in the portion of the trust attributable to that settlor's contribution.
- (b) For purposes of this section:
 - (1) During the period the power may be exercised, the holder of a power of withdrawal is treated in the same manner as the settlor of a revocable trust to the extent of the property subject to the power.
 - (2) On the lapse, release, or waiver of a power of withdrawal, the holder of a power of withdrawal is not, by reason of any such power of withdrawal, treated as the settlor of the trust.
- **(c) (1) Subject to § 4-59-204, for the purposes of this section, property contributed to the following trusts is not deemed to have been contributed by the settlor, and a person who would otherwise be treated as a settlor or a deemed settlor of the following trusts shall not be treated as a settlor:**

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- **(A) an irrevocable trust that is treated as qualified terminable interest property under section 2523(f) of the Internal Revenue Code of 1986 as in effect on January 1, 2015, if the settlor is a beneficiary of the trust after the death of the settlor's spouse;**
- (B) an irrevocable trust that is treated as a general power of appointment trust under section 2523(e) of the Internal Revenue Code of 1986 as in effect on January 1, 2015, if the settlor is a beneficiary of the trust after the death of the settlor's spouse;
- (C) an irrevocable trust for the benefit of a person to the extent that the property of the trust was subject to a general power of appointment in another person.
 - (2) For purposes of this subsection (c), a person is a beneficiary whether named under the initial trust instrument or through the exercise of a limited or general power of appointment by that person's spouse or by another person.
 - (3) For purposes of subdivision (c)(1)(C) of this section, a general power of appointment means a power of appointment exercisable in favor of the holder of the power, the estate of the holder of the power, a creditor of the holder of the power, or a creditor of the estate of the holder of the power

Delaware: Del. Code Ann. Tit. 12 § 3536(c)(1)
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(a) Except as expressly provided in subsections (c) and (d) of this section, a creditor of a beneficiary of a trust shall have only such rights against or with respect to such beneficiary's interest in the trust or the property of the trust as shall be expressly granted to such creditor by the terms of the instrument that creates or defines the trust or by the laws of this State. The provisions of this subsection shall be effective regardless of the nature or extent of the beneficiary's interest, whether or not such interest is subject to an exercise of discretion by the trustee or other fiduciary, and shall be effective regardless of any action taken or that might be taken by the beneficiary. Every interest in a trust or in trust property or the income therefrom that shall not be subject to the rights of creditors of such beneficiary as expressly provided in this section shall be exempt from execution, attachment, distress for rent, foreclosure, garnishment and from all other legal or equitable process or remedies instituted by or on behalf of any creditor, including, without limitation, actions at law or in equity against a trustee or beneficiary that seeks a remedy that directly or indirectly affects a beneficiary's interest such as, by way of illustration and not of limitation, an order, whether such order be at the request of a creditor or on the court's own motion or other action, that would:

- (1) Compel the trustee or any other fiduciary or any beneficiary to notify the creditor of a distribution made or to be made from the trust;
- (2) Compel the trustee or beneficiary to make a distribution from the trust whether or not distributions from the trust are subject to the exercise of discretion by a trustee or other fiduciary;
- (3) Prohibit a trustee from making a distribution from the trust to or for the benefit of the beneficiary whether or not distributions from the trust are subject to the exercise of discretion by a trustee or other fiduciary; or
- (4) Compel the beneficiary to exercise a power of appointment or power of revocation over the trust.

Every direct or indirect assignment, or act having the effect of an assignment, whether voluntary or involuntary, by a beneficiary of a trust of the beneficiary's interest in the trust or the trust property or the income or other distribution therefrom that is unassignable by the terms of the instrument that creates or defines the trust is void. No beneficiary may waive the application of this subsection (a). For purposes of this subsection (a), the creditors of a beneficiary shall include, but not be limited to, any person that has a claim against the beneficiary, the beneficiary's estate, or the beneficiary's property by reason of any forced heirship, legitime, marital elective share, or similar rights. The provisions of this subsection shall apply to the interest of a trust beneficiary until the actual distribution of trust property to the beneficiary. Regardless of whether a beneficiary has any outstanding creditor, a trustee may make direct payment of any expense on behalf of such beneficiary to the extent permitted by the instrument that creates or defines the trust and may exhaust the income and principal of the trust for the benefit of such beneficiary. A trustee shall not be liable to any creditor of a beneficiary for paying the expenses of a beneficiary.

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(b) Notwithstanding subsection (a) of this section, a beneficiary entitled to receive all or a part of the income of a trust shall have the right to assign gratuitously in writing, at any time or from time to time, a stated fraction or percentage of the beneficiary's entire remaining income interest in such trust to the State or to any corporation, church, community chest, fund, or foundation authorized as a deduction pursuant to §§ 1107, 1108, and 1109 of Title 30 and such assignment shall be valid and binding on all parties irrespective of any restrictions on assignment contained in the instrument creating or defining the trust; provided, however, that this subsection shall not authorize a beneficiary of such a trust to reduce any part of the beneficiary's income interest which is subject to such restrictions on assignment below 50% of what such interest would be if no assignments were made under this subsection. Any interest assigned under this subsection, together with a corresponding portion of the corpus of the trust, shall be treated as a separate share and thereafter no provision of the trust permitting invasion of corpus for the benefit of the assignor shall be exercisable with respect to such share.

(c) Except as provided in subchapter VI of this Chapter 35, if the trustor is also a beneficiary of a trust, a provision that restrains the voluntary or involuntary transfer of the trustor's beneficial interest shall not prevent such trustor's creditors from satisfying their respective claims from the trustor's interest in the trust to the extent that such interest is attributable to the trustor's contributions to the trust; provided, however, that the trustor shall not be considered a beneficiary for purposes of this section merely because the trustor may be named as an additional trust beneficiary or is a proper object of the exercise of a power of appointment over trust property held by someone other than the trustor. A trustor's creditors may satisfy their respective claims from the trustor's interest in the trust to the extent provided in the preceding sentence except where the trustor has not retained any beneficial interest in the trust other than either or both:

(1) A beneficial interest that is contingent upon surviving the trustor's spouse such as, but not limited to, an interest in an inter vivos marital deduction trust in which the interest of the trustor's spouse is treated as qualified terminable interest property under § 2523(f) of the Internal Revenue Code of 1986 (26 U.S.C. § 2523(f)), as amended, an interest in an inter vivos marital deduction trust that is treated as a general power of appointment trust for which a marital deduction would be allowed under § 2523(a) and (e) of the Internal Revenue Code of 1986 (26 U.S.C. § 2523(a) and (e)), as amended, and an interest in an inter vivos trust commonly known as a "credit shelter trust" that used all or a portion of the trustor's unified credit under § 2505 of the Internal Revenue Code (26 U.S.C. § 2505), as amended; and

(2) A right to receive discretionary distributions to reimburse the trustor's income tax liability attributable to the trust.

Further, a beneficiary of a trust shall not be considered a trustor of the trust merely because of a lapse, waiver, or release of the beneficiary's right to withdraw all or a part of the trust property.

(d) For purposes of subsection (a) of this section, a creditor shall have no right against the interest of a beneficiary of a trust or against the beneficiary or trustee of the trust with respect to such interest unless:

(1) The beneficiary has a power to appoint all or part of the trust property to the beneficiary, the beneficiary's estate, the beneficiary's creditors, or the creditors of the beneficiary's estate by will or other instrument such that the appointment would take effect only upon the beneficiary's death and the beneficiary actually exercises such power in favor of the beneficiary, the beneficiary's creditors, the beneficiary's estate, or the creditors of the beneficiary's estate but then only to the extent of such exercise.

(2) The beneficiary has a power to appoint all or part of the trust property to the beneficiary, the beneficiary's creditors, the beneficiary's estate, or the creditors of the beneficiary's estate during the beneficiary's lifetime and the beneficiary actually exercises such power in favor of the beneficiary, the beneficiary's creditors, the beneficiary's estate, or the creditors of the beneficiary's estate but then only to the extent of such exercise.

(3) The beneficiary has the power to revoke the trust in whole or in part during the beneficiary's lifetime and, upon such revocation, the trust or the part thereof so revoked would be possessed by the beneficiary. This paragraph shall have no application to any part of the trust that may not be so revoked by the beneficiary.

(e) Notwithstanding subsection (a) of this section, a beneficiary of a charitable-remainder unitrust or charitable-remainder annuity trust as such terms are defined in § 664 of the Internal Revenue Code of 1986 (26 U.S.C. § 664) and any successor provision thereto, shall have the right, at any time and from time to time, by written instrument delivered to trustee, to release such beneficiary's retained interest in such a trust, in whole or in part, to a charitable organization that has or charitable organizations that have a succeeding beneficial interest in such trust. Notwithstanding subsection (a) of this section, a beneficiary may also disclaim an interest in a trust pursuant to Chapter 6 of this title.

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Florida: Fla. Stat. § 736.0505(3)

- (1) Whether or not the terms of a trust contain a spendthrift provision, the following rules apply:
- (a) The property of a revocable trust is subject to the claims of the settlor's creditors during the settlor's lifetime to the extent the property would not otherwise be exempt by law if owned directly by the settlor.
 - (b) With respect to an irrevocable trust, a creditor or assignee of the settlor may reach the maximum amount that can be distributed to or for the settlor's benefit. If a trust has more than one settlor, the amount the creditor or assignee of a particular settlor may reach may not exceed the settlor's interest in the portion of the trust attributable to that settlor's contribution.
 - (c) Notwithstanding the provisions of paragraph (b), the assets of an irrevocable trust may not be subject to the claims of an existing or subsequent creditor or assignee of the settlor, in whole or in part, solely because of the existence of a discretionary power granted to the trustee by the terms of the trust, or any other provision of law, to pay directly to the taxing authorities or to reimburse the settlor for any tax on trust income or principal which is payable by the settlor under the law imposing such tax.
- (2) For purposes of this section:
- (a) During the period the power may be exercised, the holder of a power of withdrawal is treated in the same manner as the settlor of a revocable trust to the extent of the property subject to the power.
 - (b) Upon the lapse, release, or waiver of the power, the holder is treated as the settlor of the trust only to the extent the value of the property affected by the lapse, release, or waiver exceeds the greater of the amount specified in:
 - 1. Section 2041(b)(2) or s. 2514(e); or
 - 2. Section 2503(b) and, if the donor was married at the time of the transfer to which the power of withdrawal applies, twice the amount specified in s. 2503(b),of the Internal Revenue Code of 1986, as amended.
- (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.**

Kentucky: Ky. Rev. Stat. Ann. § 386B.5-020(8)(a)(1)-(3)

386B.5-020 Spendthrift trusts.

- (1) As used in this section, unless the context otherwise requires, "spendthrift trust" means a trust in which by the terms of the instrument creating it a valid restraint on the voluntary and involuntary alienation of the interest of a beneficiary is imposed.
- (2) Estates of every kind held or possessed in trust shall be subject to the debts and charges of the beneficiaries thereof the same as if the beneficiaries also owned the similar legal interest in the property, unless the trust is a spendthrift trust.
- (3) Specific language shall not be necessary to create a spendthrift trust, and it shall be sufficient if the instrument creating the trust manifests an intention to create a spendthrift trust.
- (4) If an instrument creating a trust provides that a beneficiary is entitled to receive income of the trust and that his interest shall not be alienable by him and shall not be subject to alienation by operation of law or legal process, the restraint on the voluntary and involuntary alienation of his right to income due and to accrue shall be valid.

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(5) If an instrument creating a trust provides that a beneficiary is entitled to receive principal of the trust at a future time and that his interest shall not be alienable by him and shall not be subject to alienation by operation of law or legal process, the restraint on the voluntary and involuntary alienation of his right to principal shall be valid.

(6) Although a trust is a spendthrift trust, the interest of the beneficiary shall be subject to the satisfaction of an enforceable claim against the beneficiary:

(a) By the spouse or child of the beneficiary for support, or by the spouse for maintenance;

(b) If the trust is not a trust described in subsection (7)(b) of this section, by providers of necessary services rendered to the beneficiary or necessary supplies furnished to him; and

(c) By the United States or this Commonwealth for taxes due from him or her on account of his or her interest in the trust or the income therefrom.

(7) (a) If a person creates for his or her own benefit a trust with a provision restraining the voluntary or involuntary alienation of his or her interest, his or her interest nevertheless shall be subject to alienation by operation of law or legal process.

(b) This subsection shall not be construed to subject to alienation any interest in an individual retirement account or annuity, tax-sheltered annuity, simplified employee pension, pension, profit-sharing, stock bonus, or other retirement plan described in the Internal Revenue Code of 1986, as amended, which qualifies for the deferral of current income tax until the date benefits are distributed.

(c) For purposes of this subsection, a person has not created a trust for such person's own benefit solely because a trustee who is not such person is authorized under the trust instrument to pay or reimburse such person for, or pay directly to the taxing authorities, any tax on trust income or principal that is payable by such person under the law imposing the tax.

(8) **(a) For the purposes of this section, amounts and property contributed to the following trusts are not deemed to have been contributed by the settlor of the trust, and a person who would otherwise be treated as a settlor or a deemed settlor of the following trusts shall not be treated as a settlor:**

1. An irrevocable inter vivos marital trust that is treated as qualified terminable interest property under 26 U.S.C. sec. 2523(f), as amended, if the settlor is a beneficiary of the trust after the death of the settlor's spouse;

2. An irrevocable inter vivos marital trust that is treated as a general power of appointment trust under 26 U.S.C. sec. 2523(e), as amended, if the settlor is a beneficiary of the trust after the death of the settlor's spouse;

3. An irrevocable inter vivos trust for the spouse of the settlor that does not qualify for the gift tax marital deduction if the settlor is a beneficiary of the trust only after the death of the settlor's spouse;

4. A special needs trust as defined in KRS 387.860, including a trust established pursuant to judicial action under KRS 387.855;

5. A trust created under 42 U.S.C. sec. 1396p(d)(4)(A) or (C); and

6. A trust created under 42 U.S.C. sec. 1396p(c)(2)(B).

(b) For the purposes of this subsection, a person is a beneficiary whether so named under the initial trust instrument or through the exercise by that person's spouse or by another person of a limited or general power of appointment.

(c) For the purposes of this section, the settlor shall be any person who:

1. Created the trust;

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2. Contributed property to the trust; or
3. Is deemed to have contributed property to the trust.

Maryland:	Md. Est. & Tr. Code Ann. § 14.5-1003(a)(1)-(2)
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(a) An individual who creates a trust may not be considered the settlor of that trust with regard to the individual's interest in the trust if:

(1) That interest is the authority of the trustee under the trust instrument or any other provision of law to pay or reimburse the individual for any tax on trust income or trust principal that is payable by the individual under the law imposing that tax; or

(2) All of the following apply:

(i) The individual creates or has created the trust for the benefit of the individual's spouse;

(ii) The trust is treated as qualified terminable interest property under § 2523(f) of the Internal Revenue Code of 1986; and

(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.

(b) A creditor of an individual described in subsection (a) of this section may not attach, exercise, reach, or otherwise compel distribution of:

(1) Any principal or income of the trust;

(2) Any principal or income of any other trust to the extent that the property held in the other trust is attributable to a trust described in subsection (a)(2) of this section;

(3) The individual's interest in the trust; or

(4) The individual's interest in any other trust to the extent that the property held in the other trust is attributable to a trust described in subsection (a)(2) of this section.

(c) This section may not be construed to affect any State law with respect to a fraudulent transfer by an individual to a trustee.

Michigan:	Mich. Comp. Laws § 700.7506(4)
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(1) Whether or not the terms of a trust contain a spendthrift provision, the following rules apply:

(a) During the lifetime of the settlor, the property of a revocable trust is subject to claims of the settlor's creditors.

(b) After the death of a settlor, and subject to the settlor's right to direct the source from which liabilities will be paid, the property of a trust that at the settlor's death was revocable by the settlor, either alone or in conjunction with another person, is subject to expenses, claims, and allowances as provided in section 7605.

(c) With respect to an irrevocable trust, a creditor or assignee of the settlor may reach no more than the lesser of the following:

(i) The claim of the creditor or assignee.

(ii) The maximum amount that can be distributed to or for the settlor's benefit exclusive of sums to pay the settlor's taxes during the settlor's lifetime.

(2) If a trust has more than 1 settlor, the amount a creditor or assignee of a particular settlor may reach under subsection (1)(c) shall not exceed the settlor's interest in the portion of the trust attributable to that settlor's contribution.

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(3) A trust beneficiary is not considered a settlor merely because of a lapse, waiver, or release of a power of withdrawal over the trust property.

(4) An individual who creates a trust shall not be considered a settlor with regard to the individual's retained beneficial interest in the trust that follows the termination of the individual's spouse's prior beneficial interest in the trust if all of the following apply:

(a) The individual creates, or has created, the trust for the benefit of the individual's spouse.

(b) The trust is treated as qualified terminable interest property under section 2523(f) of the internal revenue code, 26 USC 2523.

(c) The individual retains a beneficial interest in the trust income, trust principal, or both, which beneficial interest follows the termination of the individual's spouse's prior beneficial interest in the trust.

New Hampshire:	564-B:5-505A(e)(3)-(4)
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(a) To the extent that a settlor's interest in an irrevocable trust is not subject to a spendthrift provision, a creditor or assignee of the settlor may reach the maximum amount of trust property that can be distributed to or for the benefit of the settlor.

(b) If the trust has more than one settlor, then the amount that a creditor or assignee of a particular settlor may reach under subsection (a) may not exceed the settlor's interest in the portion of the trust attributable to that settlor's contribution.

(c) A settlor may not transfer the settlor's interest in an irrevocable trust in violation of a spendthrift provision.

(d) To the extent that a settlor's interest in an irrevocable trust is subject to a spendthrift provision, a creditor or assignee of the settlor may not reach:

(1) The settlor's interest in the trust; or

(2) A distribution from the trust before its receipt by the settlor.

(e) Subsection (d) shall apply to any type of irrevocable trust, including:

(1) A charitable remainder annuity trust within the meaning of section 664(d)(1) of the Internal Revenue Code;

(2) A charitable remainder unitrust within the meaning of section 664(d)(2) of the Internal Revenue Code;

(3) A trust described in section 2523(e) of the Internal Revenue Code;

(4) A trust described in section 2523(f) of the Internal Revenue Code;

(5) An irrevocable special needs trust established for a disabled person as described in 42 U.S.C. section 1396p(d)(4) or similar federal law governing the transfer to such a trust;

(6) A trust in which a trustee, trust advisor, or trust protector has a duty or a discretionary power to:

(A) Pay directly to any taxing authority any tax that is:

(i) Imposed on the trust's income or principal; and

(ii) Payable by the settlor under the law imposing the tax;

(B) Reimburse the settlor for any tax described in subsection (g)(6)(A); or

(C) Direct a trustee, trust advisor, or trust protector to take the action described in

subsection (e)(6)(A) or (e)(6)(B); and

(7) A trust in which the settlor has:

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- (A) The power to reacquire trust property by substituting other property of an equivalent value; or
- (B) Any power of administration within the meaning of section 675(4) of the Internal Revenue Code.

(f) Notwithstanding RSA 545-A:9, a creditor or assignee of a settlor may not commence a judicial proceeding with respect to the settlor's transfer of property to an irrevocable trust that contains a spendthrift provision after the later of:

- (1) Four years after the transfer is made; or
- (2) If the creditor or assignee is a creditor or assignee of the settlor when the transfer is made, one year after the creditor or assignee discovers or reasonably should have discovered the transfer.

(g) For purposes of subsection (f) and RSA 545-A:4, a creditor or assignee of a settlor shall prove that, with respect to the creditor or assignee, the settlor's transfer to the trust was fraudulent.

(h) Notwithstanding any law to the contrary, a person shall not have any claim against any of the following persons to the extent that the claim is based in any way on a settlor or other person availing or seeking to avail himself, herself, or itself of the benefits of this section:

- (1) A trustee;
- (2) A trust advisor;
- (3) A trust protector;

- (4) A person who advised a settlor, trustee, trust advisor, or trust protector concerning trust, the trust's formation, any transfer of property to the trust, or the application of this section; or
- (5) A person who was involved in counseling, drafting, preparing, or executing:
 - (A) With respect to the trust, a trust instrument; or
 - (B) A governing instrument of a corporation, partnership, limited partnership, limited liability company, or other entity, the interests of which a settlor transferred to the trust.

(i) Notwithstanding any law to the contrary, a person may not commence a judicial proceeding seeking the enforcement of a judgment entered by a court or other body having adjudicative authority or asserting any other claim if:

- (1) The judgment or claim is based in any way on a settlor's transfer of property to an irrevocable trust that contains a spendthrift provision; and
- (2) With respect to the transfer, a claim of the creditor or assignee of the settlor would be barred under subsection (f).

(j) Subsections (h) and (i) shall not affect:

- (1) Any claim by a settlor;
- (2) Any claim by a beneficiary against a current or former trustee, trust advisor, or trust protector for a breach of trust; or
- (3) Any claim by a trustee, trust advisor, or trust protector.

(k) If 2 or more transfers of property are made to a trust that contains a spendthrift provision, then the following shall apply:

- (1) For the purpose of determining whether, under this section, a creditor or other person may commence a judicial proceeding with respect to a specific transfer, any subsequent transfer shall be disregarded; and
- (2) Any distribution from a trust to a settlor or other beneficiary shall be deemed to have been made from:
 - (A) First, the most recent transfer to the extent of the previously undistributed portion of that transfer; and
 - (B) Subsequently, each preceding transfer in reverse chronological order to the extent of the previously undistributed portion of that transfer.

(l) A creditor or assignee of a settlor may not compel the settlor to exercise any right or power that, in any fiduciary or nonfiduciary capacity, the settlor has under the terms of the trust, including:

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- (1) Any power of appointment;
- (2) Any power to direct or veto a distribution;
- (3) Any power to reacquire trust property by substituting other property of an equivalent value;
- (4) Any power of administration within the meaning of section 675(4) of the Internal Revenue Code;
- (5) Any power to appoint or remove a trustee, trust advisor, or trust protector; or
- (6) Any right to receive reports, notices, or other information concerning the trust and its administration.

(m) This section shall not affect the application of:

- (1) In the case of a trust that was revocable immediately before the settlor's death, RSA 564-B:5-505(b);
- (2) RSA 564-B:5-505(e); or
- (3) Except as otherwise provided in this section, RSA 545-A or a similar law of another state having jurisdiction over a transfer of property.

(n) To the extent that a settlor's interest in an irrevocable trust is subject to a spendthrift provision, the settlor's interest:

(1) Is not property for purposes of RSA 458:16-a, I, to the extent that:

- (A) The settlor's interest is subject to a spendthrift provision; and
- (B) The settlor transferred the property to the trust more than 30 days before his or her marriage to the individual seeking to claim that the settlor's interest is property for purposes of RSA 458:16-a, I, unless that individual expressly consented to the transfer; and

(2) Shall not be subject to any forced heirship, legitime, forced share, or any similar heirship rights under the laws of any jurisdiction.

(o) A spendthrift provision is unenforceable against a claim of this state or the United States to the extent that a statute of this state or federal law so provides.

(p) A spendthrift provision is a restriction on the transfer of the settlor's beneficial interest that is enforceable under nonbankruptcy law within the meaning of 11 U.S.C. section 541(c)(2).

(q) Whether or not an irrevocable trust contains a spendthrift provision, an exception creditor of the settlor may reach the trust property to the extent permitted under subsection (q)(2).

(1) For purposes of this subsection, the following definitions apply:

(A) "Exception creditor" means, with respect to a settlor:

- (i) An individual to the extent that there is a judgment or court order against the settlor for child support in this or any other state; or
- (ii) A spouse or former spouse to the extent that there is a judgment or court order against the settlor for basic alimony.

(B) "Basic alimony" means the portion of alimony attributable to the most basic food, shelter, and medical needs of the spouse or former spouse if the judgment or court order expressly specifies that portion.

(2) The court shall direct the trustee to pay to the exception creditor an amount that is equitable under the circumstances, but not more than the lesser of:

(A) The amount that is necessary to satisfy the judgment or court order for:

- (i) In the case of an exception creditor described in subsection (q)(1)(A)(i), child support; or
- (ii) In the case of an exception creditor described in subsection (q)(1)(A)(ii), basic alimony; and

(B) The maximum amount of trust property that can be distributed to or for the benefit of the settlor from the trust.

(3) This subsection shall not apply to any irrevocable trust described in subsection (e)(1), (e)(2), (e)(3), (e)(4), or (e)(5).

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(4) Subject to subsection (q)(2), subsections (a) and (f) shall not apply to an exception creditor.

Source. 2017, 257:21, eff. Sept. 16, 2017.

North Carolina: N.C. Gen. Stat. 36C-5-505(c)

§ 36C-5-505. Creditor's claim against settlor.

(a) Subject to the other applicable law, whether or not the terms of a trust contain a spendthrift provision or the interest in the trust is a discretionary trust interest as defined in G.S. 36C-504(a)(2) or a protective trust interest as defined in G.S. 36C-5-508, the following rules apply:

(1) During the lifetime of the settlor, the property of a revocable trust is subject to claims of the settlor's creditors.

(2) With respect to an irrevocable trust, a creditor or assignee of the settlor may reach the maximum amount that can be distributed to or for the settlor's benefit. If a trust has more than one settlor, the amount the creditor or assignee of a particular settlor may reach may not exceed the settlor's interest in the portion of the trust attributable to that settlor's contribution.

(2a) Notwithstanding subdivision (2) of this subsection, the trustee's discretionary authority to pay directly to the taxing authorities or to reimburse the settlor for any tax on trust income or trust principal that is payable by the settlor under the law imposing the tax shall not be considered to be an amount that can be distributed to or for the settlor's benefit, and a creditor or assignee of the settlor shall not be entitled to reach any amount.

(3) After the death of a settlor, and subject to the settlor's right to direct the source from which liabilities will be paid, the property of a trust that was revocable at the settlor's death is subject to claims of the settlor's creditors, costs of administration of the settlor's estate, the expenses of the settlor's funeral and disposal of remains, and statutory allowances to a surviving spouse and children to the extent that the settlor's probate estate is inadequate to satisfy those claims, costs, expenses, and allowances, unless barred by applicable law.

(b) For purposes of this section, with respect to a power of withdrawal over property of a trust exercisable by a holder of the power other than the settlor of the trust, both of the following shall apply:

(1) The property subject to the exercise of the power shall be subject to the claims of the creditors of the holder only when and to the extent that the holder exercises the power.

(2) The lapse, release, or waiver of a power shall not be deemed to be an exercise of the power and shall not cause the holder to be treated as a settlor of the trust.

(c) Subject to the Uniform Voidable Transactions Act, Article 3A of Chapter 39 of the General Statutes, for purposes of this section, property contributed to the following trusts is not considered to have been contributed by the settlor and a person who would otherwise be treated as a settlor or a deemed settlor of the following trusts may not be treated as a settlor:

(1) If the settlor is a beneficiary after the death of the settlor's spouse:

a. An irrevocable inter vivos marital trust that is treated as a general power of appointment trust described in section 2523(e) of the Internal Revenue Code.

b. An irrevocable inter vivos marital trust that is treated as a qualified terminable interest trust under section 2523(f) of the Internal Revenue Code.

c. An irrevocable inter vivos trust of which the settlor's spouse is a beneficiary during the spouse's lifetime but which does not qualify for the federal gift tax marital deduction, and during the lifetime of the settlor's spouse (i) the settlor's spouse is the only beneficiary or G.S. 36C-5-505

(ii) the settlor's spouse and any issue of the settlor or the settlor's spouse, or both, are the only beneficiaries.

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d. Another trust, to the extent that the property of the other trust is attributable to property passing from a trust described in sub-subdivisions a., b., and c. of this subdivision.

For purposes of this subdivision, notwithstanding the provisions of G.S. 36C-1-103(3), the settlor is a beneficiary whether so named under the initial trust instrument or through the exercise of a limited or general power of appointment.

(2) An irrevocable inter vivos trust for the benefit of a person if the settlor is the person's spouse, regardless of whether or when that person was a settlor of an irrevocable inter vivos trust for the benefit of the person's spouse.

For purposes of this subsection, the "settlor's spouse" refers to the person to whom the settlor was married at the time the irrevocable inter vivos trust was created, notwithstanding a subsequent dissolution of the marriage. (2005-192, s. 2; 2007-106, s. 20; 2011-339, s. 2; 2013-91, s. 2(b); 2015-205, s. 9; 2017-212, s. 8.5(a).)

Oregon: 130.315 UTC 505

Creditor's claim against settlor. (1) Whether or not the terms of a trust contain a spendthrift provision:

(a) During the lifetime of the settlor, the property of a revocable trust is subject to claims of the settlor's creditors.

(b) A creditor or assignee of the settlor of an irrevocable trust may reach the maximum amount that can be distributed to or for the settlor's benefit. If an irrevocable trust has more than one settlor, the amount the creditor or assignee of a particular settlor may reach may not exceed the settlor's interest in the portion of the trust attributable to that settlor's contribution.

(c) If a trust was revocable at the settlor's death, the property of the trust becomes subject to creditors' claims as provided in ORS 130.350 to 130.450 when the settlor dies. The payment of claims is subject to the settlor's right to direct the priority of the sources from which liabilities of the settlor are to be paid.

(d) Notwithstanding the provisions of paragraph (b) of this subsection, the assets of an irrevocable trust may not be subject to the claims of an existing or subsequent creditor or assignee of the settlor, in whole or in part, solely because of the existence of a discretionary power granted to the trustee by the terms of the trust or any other provision of law to pay the amount of tax owed directly to the taxing authorities or to reimburse the settlor for any tax on trust income or principal that is payable or has been paid by the settlor under the law imposing the tax.

(2) For the purpose of creditors' claims, the holder of a power of withdrawal is treated in the same manner as the settlor of a revocable trust to the extent property of the trust is subject to the power. The provisions of this subsection apply to the holder of a power of withdrawal only during the period that the power may be exercised.

(3) Upon the lapse, release or waiver of a power of withdrawal, the property of the trust that is the subject of the lapse, release or waiver becomes subject to claims of creditors of the holder of the power only to the extent the value of the property exceeds the greatest of:

(a) The amount specified in section 2041(b)(2) or 2514(e) of the Internal Revenue Code, as in effect on December 31, 2012;

(b) The amount specified in section 2503(b) of the Internal Revenue Code, as in effect on December 31, 2012; or

(c) Twice the amount specified in section 2503(b) of the Internal Revenue Code, as in effect on December 31, 2012, if the donor was married at the time of the transfer to which the power of withdrawal applies.

(4) The assets of an irrevocable trust that are attributable to a contribution to an inter vivos marital deduction trust described in section 2523(e) or (f) of the Internal Revenue Code, as in effect on December 31, 2012, after the death of the spouse of the settlor of the inter vivos marital deduction trust shall be deemed to have been contributed by the settlor's spouse and not by the settlor.

(5) The assets of an irrevocable trust for the benefit of a person, including the settlor, are not subject to claims of creditors of the settlor to the extent that the property of the trust is subject to a presently exercisable general power of appointment held by a person other than the settlor.

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(6) Subsections (2) and (3) of this section do not apply to a person other than a settlor who is a beneficiary of a revocable or irrevocable trust and who is also a trustee of the trust, if the power to withdraw for the person's own benefit is limited by an ascertainable standard. [2005 c.348 §42; 2013 c.529 §9; 2017 c.17 §5]

Ohio: Ohio Revised Code § 5805.06(B)(3)
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(A) Whether or not the terms of a trust contain a spendthrift provision, all of the following apply:

(1) During the lifetime of the settlor, the property of a revocable trust is subject to claims of the settlor's creditors.

(2) Except to the extent that a trust is established pursuant to, or otherwise is wholly or partially governed by or subject to Chapter 5816. of the Revised Code, with respect to an irrevocable trust, a creditor or assignee of the settlor may reach the maximum amount that can be distributed to or for the settlor's benefit. If an irrevocable trust has more than one settlor, the amount distributable to or for a settlor's benefit that the creditor or assignee of a particular settlor may reach may not exceed that settlor's interest in the portion of the trust attributable to that settlor's contribution. The right of a creditor or assignee to reach a settlor's interest in an irrevocable trust shall be subject to Chapter 5816. of the Revised Code to the extent that that chapter applies to that trust.

(3) With respect to a trust described in 42 U.S.C. section 1396p(d)(4)(A) or (C), the court may limit the award of a settlor's creditor under division (A)(1) or (2) of this section to the relief that is appropriate under the circumstances, considering among any other factors determined appropriate by the court, the supplemental needs of the beneficiary.

(B) For purposes of this section, all of the following apply:

(1) The holder of a power of withdrawal is treated in the same manner as the settlor of a revocable trust to the extent of the property subject to the power during the period the power may be exercised.

(2) Upon the lapse, release, or waiver of the power of withdrawal, the holder is treated as the settlor of the trust only to the extent the value of the property affected by the lapse, release, or waiver exceeds the greatest of the following amounts:

(a) The amount specified in section 2041(b)(2) or 2514(e) of the Internal Revenue Code;

(b) If the donor of the property subject to the holder's power of withdrawal is not married at the time of the transfer of the property to the trust, the amount specified in section 2503(b) of the Internal Revenue Code;

(c) If the donor of the property subject to the holder's power of withdrawal is married at the time of the transfer of the property to the trust, twice the amount specified in section 2503(b) of the Internal Revenue Code.

(3) None of the following shall be considered an amount that can be distributed to or for the benefit of the settlor:

(a) Trust property that could be, but has not yet been, distributed to or for the benefit of the settlor only as a result of the exercise of a power of appointment held in a nonfiduciary capacity by any person other than the settlor;

(b) Trust property that could be, but has not yet been, distributed to or for the benefit of the settlor of a trust pursuant to the power of the trustee to make distributions or pursuant to the power of another in a fiduciary capacity to direct distributions, if and to the extent that the distributions could be made from trust property the value of which was included in the gross estate of the settlor's spouse for federal estate tax purposes under section 2041 or 2044 of the Internal Revenue Code or that was treated as a transfer by the settlor's spouse under section 2514 or 2519 of the Internal Revenue Code;

(c) Trust property that, pursuant to the exercise of a discretionary power by a person other than the settlor, could be paid to a taxing authority or to reimburse the settlor for any income tax on trust income or principal that is payable by the settlor under the law imposing the tax.

Amended by 129th General Assembly File No.201, HB 479, §1, eff. 3/27/2013.

Effective Date: 01-01-2007.

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South Carolina: S.C. Code Ann. § 62-7-505(b)(2)
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(a) Whether or not the terms of a trust contain a spendthrift provision, the following rules apply:

(1) During the lifetime of the settlor, the property of a revocable trust is subject to claims of the settlor's creditors.

(2) With respect to an irrevocable trust, a creditor or assignee of the settlor may reach the maximum amount that can be distributed to or for the settlor's benefit. If a trust has more than one settlor, the amount the creditor or assignee of a particular settlor may reach may not exceed the settlor's interest in the portion of the trust attributable to that settlor's contribution.

(3) After the death of a settlor, and subject to the settlor's right to direct the source from which liabilities will be paid, and except to the extent state or federal law exempts any property of the trust from claims, costs, expenses, or allowances, the property held in a revocable trust at the time of the settlor's death is subject to claims of the settlor's creditors, costs of administration of the settlor's estate, the expenses of the settlor's funeral and disposal of remains, and statutory allowances to a surviving spouse and children to the extent the settlor's probate estate is inadequate to satisfy those claims, costs, expenses, and allowances, unless barred by Section 62-3-801 et seq.

(b) For purposes of this section:

(1) a beneficiary who is a trustee of a trust, but who is not the settlor of the trust, cannot be treated in the same manner as the settlor of a revocable trust if the beneficiary-trustee's power to make distributions to the beneficiary-trustee is limited by an ascertainable standard related to the beneficiary-trustee's health, education, maintenance, and support;

(2) the assets in a trust that are attributable to a contribution to an inter vivos marital deduction trust described in either Section 2523(e) or (f) of the Internal Revenue Code of 1986, after the death of the spouse of the settlor of the inter vivos marital deduction trust are deemed to have been contributed by the settlor's spouse and not by the settlor.

HISTORY: 2005 Act No. 66, Section 1; 2010 Act No. 244, Section 50, eff June 7, 2010; 2013 Act No. 100, Section 2, eff January 1, 2014.

Tennessee: Tenn. Code Ann. § 35-15-505(d)
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(a) Whether or not the terms of a trust contain a spendthrift provision, the following rules apply:

(1) During the lifetime of the settlor, the property of a revocable trust is subject to claims of the settlor's creditors.

(2) Except as provided in chapter 16 of this title regarding investment services trusts and subdivisions (a)(3)-(5) regarding an irrevocable special needs trust, a creditor or assignee of the settlor of an irrevocable trust may reach the maximum amount that can be distributed to or for the settlor's benefit. If a trust has more than one (1) settlor, the amount the creditor or assignee of a particular settlor may reach may not exceed the settlor's interest in the portion of the trust attributable to that settlor's contribution;

(3) For the purposes of this section, "irrevocable special needs trust" means an irrevocable trust established for the benefit of one or more disabled persons, which includes, but is not limited to, any individual who is disabled pursuant to 42 U.S.C. § 1382c(a), as well as any individual who is disabled pursuant to any similar federal, state or other jurisdictional law or regulation, or has a condition that is substantially equivalent to one that qualifies them to be so disabled in accordance with any of the above even if not officially found to be so disabled by a governmental body if one of the purposes of the trust, expressed in the trust instrument or implied from the trust instrument, is to allow the disabled person to qualify or continue to qualify for public, charitable or private benefits that might otherwise be available to the disabled person. The existence of one or more nondisabled remainder beneficiaries of the trust shall not disqualify it as an irrevocable special needs trust for the purposes of this section;

(4) No creditor or assignee of the settlor of an irrevocable special needs trust, as defined in subdivision (a)(3), may reach or compel distributions from such special needs trust, to or for the benefit of the settlor of such special needs trust, or otherwise, regardless of whether or not such irrevocable special needs trust complies with, and irrespective of the requirements of, chapter 16 of this title; and

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(5) Notwithstanding any law to the contrary, neither a creditor nor any other person shall have any claim or cause of action against the trustee or other fiduciary, or an advisor of an irrevocable special needs trust. For purposes of this subdivision (a)(5), an advisor of an irrevocable special needs trust includes any person involved in the counseling, drafting, preparation, execution or funding of an irrevocable special needs trust.

(6) After the death of a settlor, and subject to the settlor's right to direct the source from which liabilities will be paid, the property of a trust that was revocable immediately preceding the settlor's death is subject to claims of the settlor's creditors, costs of administration of the settlor's estate and the expenses of the settlor's funeral and disposal of remains. With respect to claims, expenses, and taxes in connection with the settlement of the settlor's estate, any claim of a creditor that would be barred against the fiduciary of a settlor's estate, the estate of the settlor, or any creditor or beneficiary of the settlor's estate shall be barred against the trust property of a trust that was revocable at the settlor's death, the trustee of the revocable trust, and the creditors and beneficiaries of the trust. The provisions of § 30-2-317(a) detailing the priority of payment of claims, expenses, and taxes from the probate estate of a decedent shall apply to a revocable trust to the extent the assets of the settlor's probate estate are inadequate and the personal representative or creditor or taxing authority of the settlor's estate has perfected its right to collect from the settlor's revocable trust.

(b) For purposes of this section during the period a power of withdrawal may be exercised or upon the lapse, release, or waiver of the power, the holder is treated as the settlor of the trust only to the extent the value of the property affected by the lapse, release, or waiver exceeds the greater of the amount specified in § 2041(b)(2) or 2514(e) of the Internal Revenue Code of 1986 (26 U.S.C. § 2041(b)(2) and § 2514(e)), or § 2503(b) of the Internal Revenue Code of 1986 (26 U.S.C. § 2503(b)), in each case as in effect on July 1, 2004, or as later amended.

(c) For purposes of subdivision (a)(2), the power of a trustee of an irrevocable trust, whether arising under the trust agreement or any other provision of the law, to make a distribution to or for the benefit of a settlor for the purpose of reimbursing the settlor in an amount equal to any income taxes payable on any portion of the trust principal and income that are includable in the settlor's personal income under applicable law, as well as distributions made by the trustee pursuant to such authority, shall not be considered an amount that may be distributed to or for the settlor's benefit.

(d) With respect to an irrevocable trust for which the settlor made a qualified election pursuant to 26 U.S.C. § 2523(f), the power of a trustee, and any benefit resulting to the settlor from any exercise of such power, whether arising under the trust agreement or any other provision of the law, to make a distribution to or for the benefit of a settlor or to otherwise permit the settlor to use or benefit from trust property following the death of the settlor's spouse, shall not be considered an amount that may be distributed to or for the settlor's benefit for purposes of subdivision (a)(2). This subsection (d) shall not limit a creditor's remedies under the Uniform Fraudulent Transfer Act, compiled in title 66, chapter 3, part 3, regarding the settlor's transfers to such trust.

(e) For purposes of subdivision (a)(2) and subsection (g), a person who is the holder of a power of withdrawal is not considered a settlor of the trust by failing to exercise that power of withdrawal or letting that power of withdrawal lapse.

(f) For purposes of subdivision (a)(2) and subsection (g), a person who becomes a beneficiary of a trust due to the exercise of a power of appointment by someone other than such person shall not be considered a settlor of the trust.

(g) (1) Notwithstanding § 66-3-310, no person shall bring an action with respect to a transfer of property to a spendthrift trust:

(A) If the person is a creditor when the transfer is made, unless the action is commenced within the later of two (2) years after the transfer is made or six (6) months after the person discovers or reasonably should have discovered the transfer; or

(B) If the person becomes a creditor after the transfer is made, unless the action is commenced within two (2) years after the transfer is made; and

(2) If subdivision (g)(1) applies:

(A) A person shall be deemed to have discovered the existence of a transfer at the time any public record is made of the transfer, including but not limited to, a conveyance of real property that is recorded in the office of the county register of deeds of the county in which the property is located or the filing of a financing statement under title 47,

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chapter 9, or the equivalent recording or filing of either with the appropriate person or official under the laws of a jurisdiction other than this state;

(B) No creditor shall bring an action with respect to a transfer of property to a spendthrift trust unless that creditor proves by clear and convincing evidence that the settlor's transfer to the trust was made with the intent to defraud that specific creditor; and

(i) Notwithstanding any law to the contrary, neither a creditor nor any other person shall have any claim or cause of action against the trustee or other fiduciary or an advisor of a spendthrift trust if that claim or cause of action is based in any way on any person availing themselves of the benefits of this subsection (g);

(ii) For purposes of subdivision (g)(2)(C), an advisor of a spendthrift trust includes, but is not limited to, any person involved in the counseling, drafting, preparation, execution or funding of a spendthrift trust;

(iii) For purposes of subdivision (g)(2)(C)(i), counseling, drafting, preparation, execution or funding of a spendthrift trust includes the counseling, drafting, preparation, execution and funding of a limited partnership, a limited liability company or any other type of entity if interests in the limited partnership, limited liability company or other entity are subsequently transferred to a spendthrift trust;

(3) Notwithstanding subdivision (g)(2)(C), in the same manner as provided other than by this section to trusts in general, a beneficiary, settlor, cotrustee, trust advisor or trust protector retains the right to bring a claim against a trustee or against another cotrustee, trust advisor, trust protector or any of their predecessors; however, no such claim shall arise solely because a person availed themselves, or attempted to avail themselves, of the benefits of this subsection (g);

(4) If more than one transfer of property is made to a spendthrift trust, the subsequent transfer of property to the spendthrift trust shall be disregarded for the purpose of determining whether a person may bring an action pursuant to this subsection (g) with respect to a prior transfer of property to the spendthrift trust; and any distribution to a beneficiary from the spendthrift trust shall be deemed to have been made from the most recent transfer made to the spendthrift trust;

(5) With the exception of any claim brought pursuant to subdivision (g)(3), notwithstanding any other law, no action of any kind, including, without limitation, an action to enforce a judgment entered by a court or other body having adjudicative authority, shall be brought at law or in equity against the trustee, other fiduciary or advisor of a spendthrift trust if, as of the date such action is brought, an action by a creditor with respect to a transfer of property to the spendthrift trust would be barred pursuant to this subsection (g); and

(6) This subsection (g) shall not abridge the rights of a creditor, to the extent otherwise provided by this section, to reach the maximum amount that can be distributed to or for the settlor's benefit under a spendthrift trust.

Texas: Tex. Prop. Code § 112.035(g)
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(a) A settlor may provide in the terms of the trust that the interest of a beneficiary in the income or in the principal or in both may not be voluntarily or involuntarily transferred before payment or delivery of the interest to the beneficiary by the trustee.

(b) A declaration in a trust instrument that the interest of a beneficiary shall be held subject to a "spendthrift trust" is sufficient to restrain voluntary or involuntary alienation of the interest by a beneficiary to the maximum extent permitted by this subtitle.

(c) A trust containing terms authorized under Subsection (a) or (b) of this section may be referred to as a spendthrift trust.

(d) If the settlor is also a beneficiary of the trust, a provision restraining the voluntary or involuntary transfer of the settlor's beneficial interest does not prevent the settlor's creditors from satisfying claims from the settlor's interest in the trust estate. A settlor is not considered a beneficiary of a trust solely because:

(1) a trustee who is not the settlor is authorized under the trust instrument to pay or reimburse the settlor for, or pay directly to the taxing authorities, any tax on trust income or principal that is payable by the settlor under the law imposing the tax; or

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- (2) the settlor's interest in the trust was created by the exercise of a power of appointment by a third party.
- (e) A beneficiary of the trust may not be considered a settlor merely because of a lapse, waiver, or release of:
 - (1) a power described by Subsection (f); or
 - (2) the beneficiary's right to withdraw a part of the trust property to the extent that the value of the property affected by the lapse, waiver, or release in any calendar year does not exceed the greater of the amount specified in:
 - (A) Section 2041(b)(2) or 2514(e), Internal Revenue Code of 1986; or
 - (B) Section 2503(b), Internal Revenue Code of 1986 .
 - (f) A beneficiary of the trust may not be considered to be a settlor, to have made a voluntary or involuntary transfer of the beneficiary's interest in the trust, or to have the power to make a voluntary or involuntary transfer of the beneficiary's interest in the trust, merely because the beneficiary, in any capacity, holds or exercises:
 - (1) a presently exercisable power to:
 - (A) consume, invade, appropriate, or distribute property to or for the benefit of the beneficiary, if the power is:
 - (i) exercisable only on consent of another person holding an interest adverse to the beneficiary's interest; or
 - (ii) limited by an ascertainable standard, including health, education, support, or maintenance of the beneficiary; or
 - (B) appoint any property of the trust to or for the benefit of a person other than the beneficiary, a creditor of the beneficiary, the beneficiary's estate, or a creditor of the beneficiary's estate;
 - (2) a testamentary power of appointment; or
 - (3) a presently exercisable right described by Subsection (e)(2).
- (g) For the purposes of this section, property contributed to the following trusts is not considered to have been contributed by the settlor, and a person who would otherwise be treated as a settlor or a deemed settlor of the following trusts may not be treated as a settlor:**
 - (1) an irrevocable inter vivos marital trust if:**
 - (A) the settlor is a beneficiary of the trust after the death of the settlor's spouse; and**
 - (B) the trust is treated as:**
 - (i) qualified terminable interest property under Section 2523(f), Internal Revenue Code of 1986; or**
 - (ii) a general power of appointment trust under Section 2523(e), Internal Revenue Code of 1986;**
 - (2) an irrevocable inter vivos trust for the settlor's spouse if the settlor is a beneficiary of the trust after the death of the settlor's spouse; or
 - (3) an irrevocable trust for the benefit of a person:
 - (A) if the settlor is the person's spouse, regardless of whether or when the person was the settlor of an irrevocable trust for the benefit of that spouse; or
 - (B) to the extent that the property of the trust was subject to a general power of appointment in another person.
- (h) For the purposes of Subsection (g), a person is a beneficiary whether named a beneficiary:

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- (1) under the initial trust instrument; or
- (2) through the exercise of a limited or general power of appointment by:
 - (A) that person's spouse; or
 - (B) another person.

Virginia: Va. Code Ann. § 64.2-747(B)(3)

A. Whether or not the terms of a trust contain a spendthrift provision, the following rules apply:

1. During the lifetime of the settlor, the property of a revocable trust is subject to claims of the settlor's creditors.
2. With respect to an irrevocable trust, except to the extent otherwise provided in §§ 64.2-745.1 and 64.2-745.2, a creditor or assignee of the settlor may reach the maximum amount that can be distributed to or for the settlor's benefit. If a trust has more than one settlor, the amount the creditor or assignee of a particular settlor may reach may not exceed the settlor's interest in the portion of the trust attributable to that settlor's contribution. A trustee's discretionary authority to pay directly or to reimburse the settlor for any tax on trust income or principal that is payable by the settlor shall not be considered to be an amount that can be distributed to or for the settlor's benefit, and a creditor or assignee of the settlor shall not be entitled to reach any amount solely by reason of this discretionary authority.
3. After the death of a settlor, and subject to the settlor's right to direct the source from which liabilities will be paid, the property of a trust that was revocable at the settlor's death is subject to claims of the settlor's creditors, costs of administration of the settlor's estate, the expenses of the settlor's funeral and disposal of remains, and statutory allowances to a surviving spouse and children including the family allowance, the right to exempt property, and the homestead allowance to the extent the settlor's probate estate is inadequate to satisfy those claims, costs, expenses, and allowances. This section shall not apply to life insurance proceeds under § 38.2-3122. No proceeding to subject a trustee, trust assets, or distributees of such assets to such claims, costs, and expenses shall be commenced unless the personal representative of the settlor has received a written demand by a surviving spouse, a creditor, or one acting for a minor or dependent child of the settlor, and no proceeding shall be commenced later than two years following the death of the settlor. This section shall not affect the right of a trustee to make distributions required or permitted by the terms of the trust prior to being served with process in a proceeding brought by the personal representative.

B. For purposes of this section:

1. During the period the power may be exercised, the holder of a power of withdrawal is treated in the same manner as the settlor of a revocable trust to the extent of the property subject to the power; and
2. Upon the lapse, release, or waiver of the power, the holder is treated as the settlor of the trust only to the extent the value of the property affected by the lapse, release, or waiver exceeds the greatest of (i) the amount specified in § 2041(b)(2) or 2514(e) of the Internal Revenue Code of 1986, (ii) the amount specified in § 2503(b) of the Internal Revenue Code of 1986, or (iii) two times the amount specified in § 2503(b) of the Internal Revenue Code of 1986 if the donor was married at the time of the transfer to which the power of withdrawal applies.
- 3. The assets in a trust that are attributable to a contribution to an inter vivos marital deduction trust described in either § 2523(e) or (f) of the Internal Revenue Code of 1986, after the death of the spouse of the settlor of the inter vivos marital deduction trust shall be deemed to have been contributed by the settlor's spouse and not by the settlor.**

Wisconsin: Wisc. Stat. Ann. § 701.0505(2)(e)

(1)

(a) Whether or not the terms of a trust include a spendthrift provision and except as provided in par. (b), the following rules apply to claims of a settlor's creditors:

1. During the lifetime of the settlor, the property of a revocable trust is subject to claims of the settlor's creditors.

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2. With respect to an irrevocable trust that is not a trust for an individual with a disability, upon application of a judgment creditor of the settlor, the court may, if the trust instrument requires or authorizes the trustee to make payments of income or principal to or for the settlor, order the trustee to satisfy part or all of the judgment out of part or all of the payments of income or principal as they are due, presently or in the future, or which are payable in the trustee's discretion. If a trust has more than one settlor, the amount the judgment creditor of a particular settlor may reach may not exceed the settlor's interest in the trust.

3. After the death of a settlor, and subject to the settlor's right to direct the source from which liabilities will be paid, the property of a trust that was revocable at the settlor's death is subject to claims of the settlor's creditors, costs of administration of the settlor's estate, the expenses of the settlor's funeral and disposal of remains, and statutory allowances to a surviving spouse and children to the extent the settlor's probate estate is inadequate to satisfy those claims, costs, expenses, and allowances.

(b) Assets of a trust that are exempt from claims of creditors under other statutes are not subject to par. (a).

(2) For purposes of this subchapter, all of the following apply:

(a) During the period the power may be exercised, the holder of a power of withdrawal is treated in the same manner as the settlor of a revocable trust to the extent of the property subject to the power.

(b) A beneficiary of a trust may not be considered a settlor solely because of a lapse, waiver, or release of any of the following:

1. A power described under par. (c).

2. The beneficiary's right to withdraw part of the trust property, to the extent that the value of the property affected by the lapse, waiver, or release in any year does not exceed the greater of the following:

a. The amount referenced in section 2041 (b) (2) or 2514 (e) of the Internal Revenue Code.

b. The amount referenced in section 2503 (b) of the Internal Revenue Code for each individual other than the beneficiary who makes a transfer to the trust or who is deemed to make a transfer to the trust pursuant to an election to split gifts under section 2513 (a) of the Internal Revenue Code.

(c) A beneficiary of a trust is not a settlor, has not made a voluntary or involuntary transfer of the beneficiary's interest in the trust, and does not have the power to make a voluntary or involuntary transfer of the beneficiary's interest in the trust solely because the beneficiary holds, exercises, or allows in any capacity, any of the following:

1. A presently exercisable power to consume, invade, appropriate, or distribute property to or for the benefit of the beneficiary if the power is any of the following:

a. Exercisable only with the consent of another person holding an interest adverse to the beneficiary's interest.

b. Limited by an ascertainable standard of the beneficiary.

2. A presently exercisable power to appoint any property of the trust to or for the benefit of a person other than the beneficiary, a creditor of the beneficiary, the beneficiary's estate, or a creditor of the beneficiary's estate.

3. A testamentary power of appointment.

4. A presently exercisable right described in sub. (2) (b).

(d) A beneficiary of a trust is not a settlor solely because the beneficiary is entitled to nondiscretionary distributions from the trust.

(e)

1. Contributions to the following trusts are not considered to have been contributed by the settlor:

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a. An irrevocable marital trust that is treated as qualified terminable interest property under section 2523 (f) of the Internal Revenue Code if after the death of the settlor's spouse the settlor is a beneficiary of the trust or an irrevocable trust that receives property from the trust.

b. An irrevocable marital trust that is treated as a general power of appointment trust under section 2523 (e) of the Internal Revenue Code if after the death of the settlor's spouse the settlor is a beneficiary of the trust or an irrevocable trust that receives property from the trust.

c. An irrevocable trust for the settlor's spouse if after the death of the settlor's spouse the settlor is a beneficiary of the trust or an irrevocable trust that receives property from the trust.

d. An irrevocable trust for the benefit of a person, the settlor of which is the person's spouse, regardless of whether or when the person was the settlor of an irrevocable trust for the benefit of that spouse.

e. An irrevocable trust for the benefit of a person to the extent that the property of the trust was subject to a general power of appointment in another person.

2. A person who would otherwise be treated as a settlor of a trust described in subd. 1. a. to e. is not treated as a settlor of the trust.

3. For purposes of this paragraph, notwithstanding s. 701.0103 (3), "beneficiary" means a person who satisfies s. 701.0103 (3) (a) or (b) and who is designated in a trust instrument or through the exercise of a special or general power of appointment.

(3) Any order entered by a court under this section is subject to modification upon application of an interested person.

History: 2013 a. 92 ss. 99, 108 to 110.

Wyoming: Wyo. Stat. Ann. § 4-10-506(f)

(a) Whether or not the terms of a trust contain a spendthrift provision, the following rules apply:

(i) During the lifetime of the settlor, the property of a revocable trust contributed by the settlor, and all income and appreciation thereon and proceeds thereof, is subject to claims of the settlor's creditors;

(ii) Except for discretionary trusts created in accordance with W.S. 4-10-504(f) or irrevocable trusts providing that the trustee may only make discretionary distributions to the settlor, a creditor or assignee of the settlor of an irrevocable trust without a spendthrift provision may attach the maximum amount that can be distributed to or for the settlor's benefit. If a trust has more than one (1) settlor, the amount the creditor or assignee of a particular settlor may attach shall not exceed the settlor's interest in the portion of the trust attributable to that settlor's contribution.

(b) With respect to an irrevocable trust with a spendthrift provision, a creditor or assignee of the right of a settlor are limited by the provisions of W.S. 4-10-510 et seq.

(c) With respect to irrevocable trusts providing that the trustee may only make discretionary distributions to the settlor, a creditor or assignee of the right of a settlor are limited by W.S. 4-10-504(b) if:

(i) The transfer of property to the trust by the settlor was not in violation of the Uniform Fraudulent Transfers Act by applying the same standard of proof as provided in W.S. 4-10-517 ;

(ii) At least one (1) trustee of the irrevocable trust is a qualified trustee; and

(iii) The trustee with authority to make distributions to the settlor is not a trust beneficiary, related to the settlor or subordinate to the settlor under Internal Revenue Code section 672(c) .

(d) After the death of a settlor, and subject to the settlor's right to direct the source from which liabilities will be paid, the portion of a trust that was revocable at the settlor's death, and the property subject thereto, is subject to claims of the settlor's

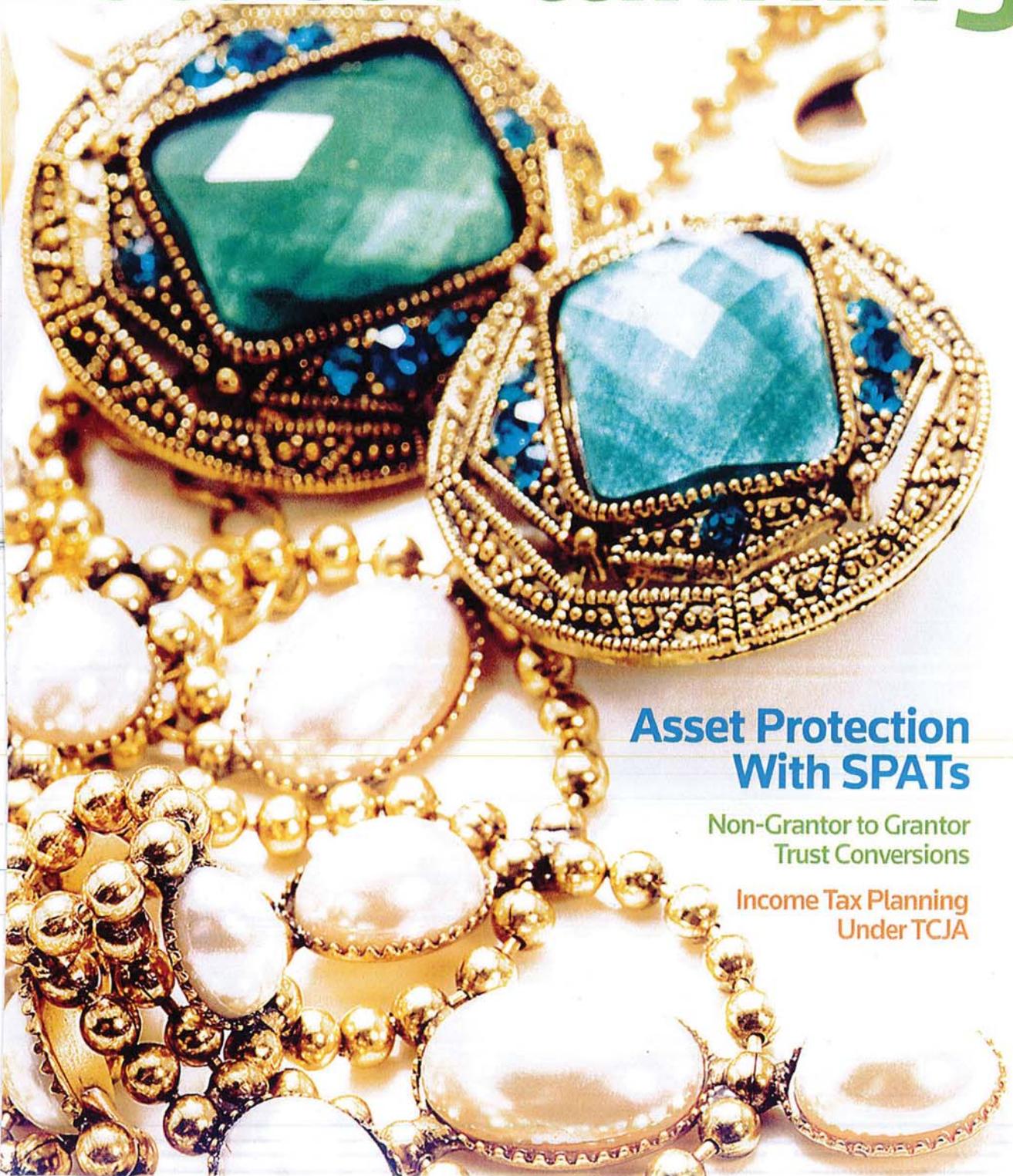
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creditors, costs of administration of the settlor's estate, the expenses of the settlor's funeral and disposal of remains to the extent the settlor's probate estate is inadequate to satisfy those claims, costs of administration and expenses.

(e) For purposes of this section, the holder of an unexercised power of withdrawal or power of appointment over trust property shall not be treated as a settlor of the trust regardless of whether the power remains exercisable or has lapsed.

(f) For purposes of this section, a person who created a trust for his or her spouse under section 2523(e) of the Internal Revenue Code , or for which the election in section 2523(f) of the Internal Revenue Code was made, shall not be treated as a settlor of the trust, as of and after the death of his or her spouse.

Estate Planning



Asset Protection With SPATs

Non-Grantor to Grantor
Trust Conversions

Income Tax Planning
Under TCJA

EXHIBIT 13

LESSONS LEARNED FROM 2012 – PREPARING FOR 2025 (OR SOONER)

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