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Post mortem estate plan adjustment

Wife is the beneficiary of a substantial Qualified Terminable Interest Property Trust (or QTIP trust for short). Her six children were remainder beneficiaries, and she received all of the trust income. Perhaps motivated by the children's impatience for their inheritance and low current interest rates, Wife proposed to divide the trust into three new trusts. Trust 1 will be identical in every way to the existing QTIP trust. Trust 2 will become a total return unitrust, in accordance with local law, which allows such transformation with the consent of the beneficiaries. Wife will receive from 3% to 5% of the value of the trust each year, valued annually. Trust 3 will be terminated immediately after creation, and the assets in that trust then will pass to the remaindermen. Wife will treat that termination as a taxable gift from her to the children, but the children will pay any gift taxes due. That fact will, in turn, reduce the value of the taxable gift and the final cost of the tax.

Wife turned to the IRS for confirmation that there aren't any tax problems with this plan. There are not, the Service confirmed in private advice. The division of the trust into three trusts will not be considered a gift and will not impair the QTIP status. The termination of Trust 3 will be a taxable gift, and, therefore, those assets will not be included in Wife's estate. The conversion of Trust 2 to a unitrust will not be a gift to anyone, and it will not require recognition of gain or loss.

QTIP trusts generally are considered unchangeable, but this case demonstrates that even irrevocable trusts may be modified to meet the changing needs of beneficiaries.

(March 2015)