First Comes Love,
Then Comes the Marital Deduction

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I. INTRODUCTION

Over the course of the last fifteen years, estate planners have witnessed a lot of changes. The gift, estate, and generation-skipping transfer tax exemption amounts became "permanent" and then doubled,[1] portability[2] and basis consistency reporting[3] were introduced, and more recently, the SECURE Act negated the effectiveness of some tried and true strategies for planning with retirement accounts.[4] One of the few constants has been the marital deduction, which generally allows spouses to transfer unlimited amounts of property to one another, whether during life or upon death, on a tax-free basis.[5]

It is easy enough to master the basic principles of the marital deduction, but knowing how and when to utilize marital deduction planning in order to obtain an ideal result for a client requires a more thorough understanding of those principles. The primary purpose of this article is to revisit familiar marital deduction planning concepts to examine how to most effectively deploy them in the current estate planning environment. This article will also highlight some of the less common ways to qualify for the marital deduction and consider how and when using an unconventional approach may be beneficial.

II. EXAMINING TRADITIONAL MARITAL DEDUCTION PLANNING

The Economic Recovery Tax Act of 1981 ("ERTA") established the unlimited marital deduction and introduced the concept of qualified terminable interest property.[6] Both concepts have been ubiquitous in estate planning for married couples ever since.

Traditional marital deduction planning tends to focus on using the estate tax marital deduction to defer the payment of all federal transfer taxes until the surviving spouse's death. To achieve this result, the deceased spouse[7] will leave all or a portion of his or her estate to the surviving spouse in a manner that qualifies for the marital deduction while relying on a bypass trust or portability to preserve the remainder of his or her estate tax exclusion amount.

All the means of qualifying for the marital deduction have one important thing in common: they all result in an interest passing to the recipient spouse in a manner that will cause estate inclusion, thereby requiring that recipient spouse to use his or her own gift and estate tax exclusion amount to transfer the interest during life or to shield it from tax at death. Put another way, if an interest passing to or for the benefit of a spouse would not be includible in his or her taxable estate, it will not qualify for the marital deduction. The Code and Regulations[8] include a

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[1] American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, 126 Stat. 2313 (2013); An Act To provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018, Pub. L. No. 115-97, 131 Stat. 2054 (2017).

[2] Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, 124 Stat. 3296 (2010); American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, 126 Stat. 2313 (2013).

[3] Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, Pub. L. No. 114-41, 129 Stat. 443 (2015).

[4] Further Consolidated Appropriations Act, 2020, Pub. L. No. 116-94, 113 Stat. 2534 (2019).

[5] I.R.C. §§ 2056, 2523. As is further detailed in the next section of the article, only certain qualified transfers are eligible for the marital deduction.

[6] Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 172 (1981).

[7] All references in this article to the "deceased spouse" shall mean the first of the spouses to die. References to the "surviving spouse" shall mean the survivor of the spouses.

[8] All references herein to the "Regulations" are to the Treasury Regulations promulgated under the Internal Revenue Code of 1986, as amended. All references herein to the "Code" are to the Internal Revenue Code of 1986, as amended.

number of other requirements that must be met to qualify for the deduction, particularly with regard to the creation of certain marital trusts, but it is still helpful to keep this key concept in mind when trying to determine whether or not an interest is deductible. The other basic requirements that must be met in order for an interest in property to qualify for the estate tax marital deduction are explored in more detail below.

A. Citizenship and Survival

The marital deduction is only available if the deceased spouse is survived by a spouse who is a U.S. citizen.[9] In most cases it is obvious whether or not the decedent was survived by a spouse, but if the order of the spouses' deaths cannot be determined by proof, then a presumption of survival provided by local law, the decedent's will (or presumably, a testamentary substitute such as a revocable trust), or otherwise will satisfy the survivorship requirement, so long as it results in an interest passing to the surviving spouse that will be includible in his or her gross estate.[10]

The citizenship requirement will be met if the surviving spouse (i) becomes a U.S. citizen before the estate tax return for the deceased spouse is filed and (ii) was a U.S. resident at all times after the deceased spouse's death and before becoming a citizen.[11] For this purpose, an estate tax return filed prior to the due date is considered filed as of the due date (including extensions), while a late return is considered filed as of the actual filing date.[12]

Note that there is an important exception to the citizenship requirement, as a transfer to a qualified domestic trust (a "QDOT") for the benefit of a non-U.S. citizen spouse will qualify for the marital deduction.[13] A QDOT must meet the following requirements:

- At least one of the trustees must be an individual who is a U.S. citizen or a domestic corporation;
- No distribution (other than a distribution of income) may be made from the trust unless a trustee who is a U.S. citizen or a domestic corporation has the right to withhold the tax imposed by Code section 2056A from such distribution;
- The trust must comply with the requirements prescribed by the Regulations to ensure the collection of any taxes imposed by Code section 2056A(b); and
- The executor of the deceased spouse's estate must make a QDOT election.[14]

In addition to the foregoing requirements, a QDOT must independently qualify for the marital deduction, whether as a general power of appointment trust, QTIP trust, charitable remainder trust, or estate trust.[15] A more robust discussion of the more technical requirements associated with the administration and taxation of QDOTs is beyond the scope of this article.[16]

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[9] I.R.C. § 2056(d).
[10] Treas. Reg. § 20.2056(c)-2(e).
[11] I.R.C. § 2056(d)(4).
[12] Treas. Reg. § 20.2056A-1(a).
[13] I.R.C. §§ 2056(d)(2), 2056A.
[14] I.R.C. § 2056A(a).
[15] Treas. Reg. § 20.2056A-2(b)(1).
[16] For a more comprehensive discussion of QDOTs, *see* Michele A. Mobley, *QDOTs: Drafting and Administering Marital Trusts for Non-U.S. Citizens*, State Bar of Texas Estate Planning and Probate Drafting Course, Houston, Texas, October 24-25, 2013.

B. Interest Must Pass to the Surviving Spouse

To be eligible for the marital deduction, an interest in property must be includible in the deceased spouse's gross estate and pass to the surviving spouse.[17] An interest will be considered to have passed to the surviving spouse if:

- It is devised or bequeathed to the spouse;
- It was jointly owned by the spouses and subject to a right of survivorship;
- It was subject to a power of appointment causing an estate inclusion exercised in favor of the surviving spouse, or alternatively, passed to the surviving spouse in default of the release or non-exercise of the power;[18] or
- It consists of proceeds of an insurance policy on the decedent's life that are received by the surviving spouse.[19]

As this list demonstrates, generally any interest in property that the surviving spouse receives outright from the deceased spouse's gross estate will be considered to have "passed" to the surviving spouse. However, there are other factors that must be considered if the surviving spouse receives an interest in property as a result of a will contest or, more notably, in the form of a life estate or other terminable interest.

The Regulations address whether or not certain interests are considered to "pass" to the surviving spouse as a result of a will contest. If the surviving spouse assigns or surrenders his or her interest under the decedent's will as part of a settlement, that interest will not be considered to have "passed" to the surviving spouse and will not qualify for the marital deduction.[20] Conversely, if an interest under the decedent's will is assigned to the surviving spouse as a result of a bona fide recognition of the surviving spouse's enforceable rights over the estate, that interest will be considered to have "passed" to the surviving spouse and will qualify for the marital deduction.[21]

An assignment made pursuant to court order issued on the merits and following a genuine contest may be presumed to provide the requisite bona fide recognition of the surviving spouse's rights. However, an assignment made pursuant to a family settlement agreement or any other similar arrangement will not necessarily be accepted as a bona fide recognition of the surviving spouse's rights.[22] For an assignment made pursuant to a settlement to qualify for the marital deduction, the settlement must have been made in good faith and be based upon an enforceable right under state law.[23]

C. Terminable Interests

Pursuant to Code section 2056(b), only certain terminable interests that pass to or in favor of the surviving spouse qualify for the marital deduction. The Regulations define a terminable interest as any interest in property that "will terminate or fail on the lapse of time or on the occurrence or

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[17] I.R.C. § 2056(a).

[18] Recall that an interest only qualifies for the marital deduction if is it includible in the deceased spouse's gross estate, so an exercise of a power of appointment over a trust that is not includible will not qualify. An interest that qualifies in this manner will most likely be subject to a general power of appointment.

[19] I.R.C. § 2056(c); Treas. Reg. § 20.2056(c)-2(a).

[20] Treas. Reg. § 20.2056(c)-2(d)(1).

[21] Treas. Reg. § 20.2056(c)-2(d)(2).

[22] *Id.*

[23] *Ahmanson Found. v. United States*, 674 F.2d 761, 775 (9th Cir. 1981).

the failure to occur of some contingency."[24] Some of the most common forms of terminable interests include life estates, annuities, and interests passing in trust.

As a general rule, a terminable interest in property passing to the surviving spouse is nondeductible if any part of that interest passes to another person for less than adequate and full consideration, resulting in that other person (or his or her heirs) possessing or enjoying any part of the property upon the failure or termination of the spouse's interest.[25] Code section 2056(b) provides for five distinct exceptions to this general rule, as detailed below.

1. 2056(b)(3): Interests Conditioned on the Spouse's Survival

If the surviving spouse's right to receive an interest is conditioned on such spouse surviving the decedent for a period of time not to exceed six months, then the interest will qualify for the marital deduction if the spouse so survives.[26] An interest that passes to the surviving spouse on the condition that he or she does not die as a result of a common disaster will also qualify.[27]

2. 2056(b)(5): Life Estate with a Power of Appointment

Code section 2056(b)(5) provides that an interest passing to or for the benefit of the surviving spouse will qualify for the marital deduction if it satisfies two main criteria: (i) the surviving spouse must be entitled to all of the income from the interest for life, payable at least annually, and (ii) the surviving spouse must hold a general power of appointment over the interest, exercisable in favor of the surviving spouse or his or her estate. If for any reason the surviving spouse is only entitled to a portion of the trust income, or if the general power of appointment only applies to portion of the interest, the marital deduction will be limited to smaller of the two portions. Regulations section 20.2056(b)-5 provides a detailed explanation of how to determine the deductible amount if the surviving spouse only has the requisite rights over a partial interest.

a) Power of Appointment Trusts

This exception to the terminable interest rules is most often utilized to create a marital trust for the benefit of the surviving spouse. At a minimum, the trust must provide for the income to be distributed to the surviving spouse at least annually, but the settlor is free to liberalize the distribution provisions to provide for more frequent distributions of income or distributions of principal.

Although a trust designed to comply with Code section 2056(b)(5) trust is sometimes referred to as a general power of appointment trust, that name is a bit misleading. If the surviving spouse is given the power to appoint trust property to his or her creditors, or to the creditors or his or her estate, he or she will have a general power of appointment over the trust.[28] Unfortunately this power would not conform with the requirements of Code section 2056(b)(5), which clearly states that the power must be exercisable in favor of the spouse or his or her estate. An inter vivos power of appointment in favor of the surviving spouse, or an unlimited withdrawal right or other power to invade trust principal given to the spouse for his or her lifetime will satisfy this

[24] Treas. Reg. § 20.2056(b)-1(b).
[25] I.R.C. § 2056(b)(1); Treas. Reg. § 20.2056(b)-1(c)(1).
[26] I.R.C. § 2056(b)(3); Treas. Reg. §20.2056(b)-3.
[27] *Id*.
[28] I.R.C. § 2041(b)(1).

requirement,[29] as will a testamentary general power of appointment in favor of the surviving spouse's estate.[30] So long as the surviving spouse or his or her estate is an object of the power, the settlor may include other permissible appointees, such as descendants or charity, if that is desirable.

Note that the settlor is not required to provide both a lifetime and a testamentary general power to the surviving spouse. So long as the spouse has one form of the requisite power, the settlor may include lesser or more restrictive powers if he or she wishes. For example, if the surviving spouse has a testamentary power to appoint to his or her estate, it is perfectly acceptable if the spouse has only a limited power to withdraw trust property during life.[31] Similarly, if the spouse has an unlimited right of withdrawal during life, he or she may have a more limited testamentary power of appointment.[32]

Whether the general power is an inter vivos or testamentary power, it must be exercisable by the surviving spouse alone and in all events. The exercise of the power cannot require the joinder or consent of any other person, nor can it be terminated by any event other than the surviving spouse's exercise or release of the power.[33] For example, a power that is not exercisable in the event of the spouse's remarriage would not qualify.[34] If the spouse is incapacitated and thus is legally incapable of exercising the general power of appointment, the spouse's practical inability to exercise the power will not affect a trust's eligibility for the marital deduction.[35]

The power must also be exercisable from the moment of the deceased spouse's death, but if the power is exercised during the administration of the deceased spouse's estate, distribution to the appointee may be delayed during the period of administration.[36] Reasonable restrictions regarding the form of the exercise of a power will not affect its qualification. For example, the trust may require that the power be exercised via a document delivered to the trustee during the spouse's lifetime or in a will that makes a specific reference to the power.[37]

A general power of appointment trust may not provide any person (other than the surviving spouse) with the power to appoint any part of the trust property to anyone other than the surviving spouse.[38] As a result, the trustee's distribution discretion may only allow for distributions to or in favor of the surviving spouse, and no third party may hold any right to appoint, withdraw, or otherwise receive trust property during the spouse's lifetime.

b) *Practical Application of 2056(b)(5)*

Power of appointment trusts were once the most widely used type of marital trust, but following the enactment of ERTA, they were eclipsed in popularity by QTIP trusts (as discussed in more detail in section II.C.4 below). As compared to a QTIP trust, a general power of appointment trust has a number of disadvantages, as follows:

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[29] Treas. Reg. § 20.2056(b)-5(g)(1)(i).
[30] Treas. Reg. § 20.2056(b)-5(g)(1)(ii).
[31] Treas. Reg. § 20.2056(b)-5(g)(5).
[32] *Id*.
[33] Treas. Reg. § 20.2056(b)-5(g)(3).
[34] *Id*.
[35] Rev. Rul. 75-350, 1975-2 C.B. 366.
[36] Treas. Reg. § 20.2056(b)-5(g)(4).
[37] *Id*.
[38] I.R.C. § 2056(b)(5); Treas. Reg. §§ 20.2056(b)-5(a)(5), (j).

- Control Over Ultimate Disposition. Due to the necessary provision of a general power of appointment in favor of the surviving spouse (or his or her estate), a general power of appointment trust provides that spouse with complete control over the ultimate disposition of the trust assets. This power enables the surviving spouse to completely override the deceased spouse's intended final disposition of the trust property and to potentially direct it to beneficiaries who may be seen as undesirable by the deceased spouse, such as children from a different relationship or a new spouse. The QTIP trust enables the deceased spouse to control the ultimate disposition of the trust assets and therefore is often viewed as a superior option, particularly for spouses who choose to provide for different remainder beneficiaries (as most often occurs with blended families or couples who do not have children).
- Allocation of GST Tax Exemption. By virtue of the general power of appointment, the assets of a 2056(b)(5) trust are includible in the surviving spouse's estate, and he or she will be considered the transferor of the trust assets for generation-skipping transfer ("GST") tax purposes. As a result, there is no opportunity for the deceased spouse to allocate his or her GST tax exemption amount to a general power of appointment trust. Because the GST tax exemption amount does not carry over through portability, it may be lost if there is no bypass trust to absorb it. As is discussed in section V.D below, if a reverse QTIP election is made pursuant to Code section 2652(a)(3), the deceased spouse's executor will be able to allocate the deceased spouse's GST tax exemption amount to a QTIP trust.
- Creditor Protection. In some jurisdictions, the surviving spouse's general power of appointment may expose the assets of a general power of appointment trust to creditors, even if the power is unexercised (although that is not a concern in Texas).[39] Because a QTIP trust will not include a general power of appointment, it may provide a higher level of creditor protection.

Due to these disadvantages, the general power of appointment trust is seldom used as the primary marital trust in modern estate plans, but it is still useful in certain circumstances. For example, estate planners in community property states like Texas sometimes rely on the provisions of Code section 2056(b)(5) to qualify a revocable trust for the marital deduction upon the deceased spouse's death. Unlike in common law states, where spouses often create individual revocable trusts, couples in community property states are more likely to create a joint revocable trust that serves as an asset management vehicle during life and a will substitute at death.

At the first spouse's death, the surviving spouse's one-half interest in the community property and his or her separate property will typically remain in the revocable trust. In some cases, the deceased spouse's community and separate property interests may be directed to pass entirely to a bypass trust, QTIP trust, or some combination of the two, but it is not uncommon for some or all of these interests to remain in the revocable trust for the benefit of the surviving spouse. For instance, a couple may decide it is best to retain the deceased spouse's interest in the primary residence, tangible personal property, and other "use" assets in the revocable trust in order to avoid a probate of those assets at the surviving spouse's death (as would be required if held directly by the surviving spouse) or to avoid putting the surviving spouse in the position of co-owing those assets with an irrevocable bypass or QTIP trust (as would be required if the deceased spouse's interests were used to fund one or both of those trusts). Some couples choose to rely on portability

[39] Tex. Prop. Code § 112.035(f)(2).

to preserve the deceased spouse's exclusion amount and prefer to provide the surviving spouse with unfettered access to the deceased spouse's estate by way of the revocable trust, which removes those assets from the surviving spouse's probate estate and facilitates a transition of the management of those assets in the event the surviving spouse loses capacity.

Whatever the reasoning may be for directing any share of the deceased spouse's property to the revocable trust, it is important to ensure that the trust will qualify for the marital deduction if it will be used for that purpose. Just because the surviving spouse retains the right to revoke the trust in receipt of the deceased spouse's property does not necessarily mean that the trust will qualify.[40] The trust must still meet the requirements under Code section 2056, whether as a general power of appointment trust, QTIP trust, or estate trust. For most couples, the general power of appointment trust provisions will likely be a natural fit, as providing the surviving spouse with full control over trust income and principal during life and at death is often the desired result if the spouses have chosen to keep the deceased spouse's property in the revocable trust.

Before providing for any part of the deceased spouse's estate to remain in the revocable trust, be sure that there is no "spray power" or any other provisions that may jeopardize the availability of the marital deduction. Revocable trusts are often intended to serve as an asset management vehicle in the event of incapacity, so it is sometimes prudent to provide the trustee with the authority to make distributions to the settlors' children, particularly if they are minors or are otherwise dependent on their parents for financial support, in the event of the settlors' incapacity. This is especially true if the trust has been substantially or fully funded by the settlors, meaning that assets would be out of reach for an agent under a durable power of attorney. However, this type of power would prevent the trust from qualifying for the marital deduction. Rather than include a spray power, the trust could authorize the trustee to make distributions to a settlor to provide for the minor children whom the settlor has a legal obligation to support.[41]

If the settlors feel strongly about (i) passing part or all of the deceased spouse's estate to the revocable trust and (ii) including a provision in the revocable trust that would disqualify the trust for the marital deduction, there are a couple of potential solutions. First, the trust could provide for outright disposition of the relevant property to the surviving spouse, who may then immediately transfer the property back to the revocable trust. Another option is for the trust to provide for an outright distribution to the surviving spouse, but with an instruction to the trustee to fund the assets into the revocable trust absent notice to the contrary from the surviving spouse within a certain period of time following the deceased spouse's death.

A general power of appointment trust may also offer a better income tax result than a QTIP trust for spouses who are unlikely to owe estate tax at either spouse's death. Even though spouses with moderate amounts of wealth have the option of leaving their property outright to one another with minimal risk of estate tax exposure, they may still prefer to use a trust structure to provide some degree of protection against divorcing spouses and creditors and to have the option of management by a co-trustee or successor trustee in the event of the surviving spouse's incapacity or inability to serve. A QTIPable trust would provide all of those benefits during the surviving spouse's lifetime but may ultimately preclude the possibility of a basis adjustment at the surviving

[40] *See* I.R.S. Tech. Adv. Mem. 200444023 (July 12, 2004). The Service determined that the revocable trust qualified for the marital deduction but relied primarily on the surviving spouse's right to receive all trust income and general power of appointment to make that determination. The survivor's power to revoke the trust does not appear to have been a significant factor.

[41] Treas. Reg. § 20.2056(b)-5(j).

spouse's death. This is because in order for a QTIP trust to qualify for marital deduction, the deceased spouse's executor must make the QTIP election on an estate tax return. If the value of the deceased spouse's estate is well below the current estate tax exclusion amount of $13.61 million per person, there will be no need to file an estate tax return (unless the executor wishes to make the portability election). Without the QTIP election, the assets of the QTIPable trust will not be includable in the surviving spouse's gross estate at his or her death and thus will not receive a basis adjustment under Code section 1014.[42]

In contrast, a general power of appointment trust will be included in the surviving spouse's gross estate pursuant to Code section 2041, so the assets in that trust will receive a basis adjustment at the surviving spouse's death.[43] There will be no need to file an estate tax return to achieve that result. Furthermore, if the spouses are willing to sacrifice spendthrift protection, the surviving spouse could be granted an inter vivos general power of appointment over the trust, exercisable in favor of himself or herself, to qualify the trust for grantor trust treatment under Code section 678.[44]

3. 2056(b)(6): Life Insurance or Annuity Payments with a Power of Appointment

Certain interests consisting of proceeds of a life insurance, endowment, or annuity contract passing from a decedent to his or her surviving spouse also qualify for the marital deduction.[45] To be deductible, the proceeds (or the interest accruing on the proceeds) must be payable exclusively to the surviving spouse on an annual or more frequent basis, and the surviving spouse must also have a general power of appointment over the interest exercisable in favor of the surviving spouse or his or her estate.[46]

4. 2056(b)(7): Qualified Terminable Interest Property

Code section 2056(b)(7) provides that qualified terminable interest property ("QTIP") passing to or for the benefit of the surviving spouse will qualify for the marital deduction. Prior to the introduction of this provision under ERTA, all of the options for passing an interest to the surviving spouse in a qualifying manner resulted in the surviving spouse having control over the ultimate disposition of that interest. Because a deceased spouse may direct how assets held in the QTIP trust will pass following the surviving spouse's death, the QTIP trust quickly became one of the most popular tools for marital deduction planning.

In order to be classified as a qualified terminable interest, the property must (i) pass from the deceased spouse, (ii) provide the surviving spouse with a qualifying income interest for life, and (iii) be subject to the election under Code section 2056(b)(7).[47] The first requirement has already been discussed in section II.B above, while the third requirement and the various options for making a QTIP election are discussed in more detail in section V to follow.

With regard to the second requirement, the surviving spouse will be considered to have a qualifying income interest for life if he or she is entitled to all of the income from the interest on an annual or more frequent basis, and so long as no person has a power to appoint any part of the

[42] *See* I.R.C. § 2044 and the discussion in section VI.B herein.
[43] I.R.C. § 1014(b)(4).
[44] Under Tex. Prop. Code § 112.035(f)(1), spendthrift protection does not extend to a trust subject to a presently exercisable general power of appointment.
[45] I.R.C. § 2056(b)(6); Treas. Reg. § 20.2056(b)-6(a).
[46] *Id*.
[47] I.R.C. § 2056(b)(7)(B)(i).

interest to any person other than the surviving spouse.[48] An income interest for a term of years or that will terminate upon the occurrence of some specified event (e.g., the surviving spouse's remarriage) is not a qualifying income interest for life.[49] However, if the surviving spouse's receipt of a qualifying income interest for life is contingent upon the deceased spouse's executor making the QTIP election, or if any part of the interest that is not subject to a QTIP election will pass to or for the benefit of other persons, the interest will still qualify for the marital deduction if the QTIP election is made and the other requirements are satisfied.[50]

Much like an interest that qualifies for the marital deduction pursuant to Code section 2056(b)(5), the mandatory distributions of income to the surviving spouse represent the floor rather than the ceiling. More specifically, if the trustee of a QTIP trust is authorized to make distributions of principal from that trust to or for the benefit of the surviving spouse, that authority will not cause the interest in that trust to fail as a qualifying income interest for life.[51]

The prohibition on any person having the power to appoint any part of a QTIP interest to any person other than the surviving spouse impacts a QTIP trust in two significant ways. First, it means that the trustee, other fiduciaries (such as trust protectors, special trustees, etc.), and other third parties may not have the authority to distribute or direct trust property to anyone other than the surviving spouse. Second, it means that the surviving spouse may not hold an inter vivos power of appointment over the trust.[52] However, the surviving spouse is permitted to hold a testamentary special power of appointment over a QTIP trust.[53]

Although Code section 2056(b)(7) is most often relied upon to create a QTIP trust for the surviving spouse's benefit, it can have other applications. An annuity that is payable solely to the surviving spouse for the remainder of his or her lifetime is treated as a qualifying income interest for life, and the executor of the deceased spouse's estate will automatically be treated as having made the QTIP election for such an annuity unless the executor provides otherwise in the estate tax return.[54]

5. 2056(b)(8): Charitable Remainder Trusts

In addition to the QTIP provisions, ERTA also introduced Code section 2056(b)(8), which provides that an interest passing to a qualified charitable remainder trust will qualify for the marital deduction if the surviving spouse is the only non-charitable beneficiary of that trust.

For purposes of this section, a qualified charitable remainder trust means a charitable remainder annuity trust ("CRAT") or a charitable remainder unitrust ("CRUT"), as described in Code section 664.[55] Only the value of the annuity or unitrust interest that passes to the surviving

[48] I.R.C. § 2056(b)(7)(B)(ii).
[49] Treas. Reg. § 20.2056(b)-7(d)(3)(i).
[50] *Id*.
[51] Treas. Reg. § 20.2056(b)-7(d)(6).
[52] Treas. Reg. § 20.2056(b)-7(d)(1).
[53] I.R.C. § 2056(b)(7)(B)(ii). Note that a surviving spouse should not be given a testamentary general power of appointment over a QTIP trust, as that power would qualify the full value of the trust for the marital deduction and would preclude the deceased spouse's executor from having the flexibility to make a partial QTIP election, the so-called "reverse QTIP" election to permit an allocation to the trust of the deceased spouse's GST tax exemption, or no QTIP election over that trust in the event that outcome is desirable.
[54] I.R.C. § 2056(b)(7)(C).
[55] I.R.C. § 2056(b)(8)(B)(iii).

spouse will qualify for the marital deduction, while the remainder interest will qualify for the charitable deduction under Code section 2055.[56] A charitable remainder trust may generally continue for the life or lives of the specified individuals or for a term of years not to exceed 20 years.[57] So long as the other requirements are met, a charitable remainder trust with either type of term will qualify for the marital deduction as long as the surviving spouse is the only non-charitable beneficiary.[58]

A charitably inclined individual who wants to ensure that his or her spouse will be provided for upon death may consider incorporating either a charitable remainder trust or a QTIP trust with one or more charitable organizations as the remainder beneficiaries into his or her estate plan. Both trusts can provide the surviving spouse with a regular stream of payments for the duration of his or her lifetime, and both will qualify for the marital deduction. As a result, an individual faced with such a choice must consider certain other factors.

a) Taxation on Gain

All of the income that is retained by a charitable remainder trust, including capital gains, is generally exempt from income tax.[59] As trust income is distributed to the non-charitable beneficiary, it will be taxable to that beneficiary,[60] but because the income is distributed gradually the resulting tax liability is similarly spread out over time.

In contrast, all the income of a QTIP trust will be taxable to either the surviving spouse or the trust. Because a QTIP trust must distribute all of its income to the surviving spouse on an annual basis, the income is typically taxable to the surviving spouse, but that is not always the case. In this context, the "income" that is subject to mandatory distribution means the income as determined in accordance with the terms of the trust instrument and local law,[61] so fiduciary accounting income and taxable income are not always equivalent. Absent a valid exercise of a trustee's power to adjust between principal and income, capital gains are typically classified as principal for state law purposes, despite being considered income for income tax purposes. As a result, a capital gain incurred by a QTIP trust will likely be taxable to the trust.[62]

The assets passing to a QTIP trust will receive a basis adjustment as of the deceased spouse's date of death,[63] so capital gains may not be a significant concern barring a confluence of events in which a capital asset appreciates significantly in value during the period between the spouses' deaths and needs to be sold by the trustee prior to the surviving spouse's death, when the remaining assets will again have their basis adjusted to fair market value. Nevertheless, a charitable remainder trust may be a more effective vehicle for reducing or deferring income tax liability.

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[56] Treas. Reg. § 20.2056(b)-8(a)(1).
[57] I.R.C. §§ 664(d)(1)(A), 664(d)(2)(A); Treas. Reg. § 1.664-3(1)(5)(i).
[58] Treas. Reg. § 20.2056(b)-8(a)(2).
[59] I.R.C. § 664(c). Note that a charitable remainder trust that has unrelated business taxable income will be subject to an excise tax on such income.
[60] I.R.C. § 664(b); Treas. Reg. § 1.664-1(d). A discussion of the "tier" system governing the income taxation of distributions from a charitable remainder trust is beyond the scope of this article, but the Regulations contain a number of detailed and helpful examples.
[61] I.R.C. § 643(b).
[62] *See*, *e.g.*, Tex. Prop. Code § 116.005(a).
[63] I.R.C. § 1014(a)(1).

b) Flexibility to Change Course

The settlor of a charitable remainder trust may provide the noncharitable beneficiary with a power of appointment to designate the charitable remainder beneficiaries of the trust.[64] The power must be strictly limited so as to only be exercisable in favor of one or more charitable organizations as described in Code sections 170(c), 2055(a), and 2522(a), but it still provides some degree of flexibility over the ultimate disposition of trust assets.

The settlor of a QTIP trust is free to provide the surviving spouse with a testamentary special power of appointment over the trust. The objects of that power can be limited to a specific class of individuals, such as the settlor's descendants, or they can include any persons or organizations other than the surviving spouse, the surviving spouse's estate, or creditors of the surviving spouse or his or her estate. Under the right circumstances, powers of appointment are an excellent way to add flexibility to a trust's terms. If a married couple's goals are aligned, providing the survivor with a testamentary special power of appointment enables him or her to make adjustments to ensure that those goals will continue to be met despite changes in circumstances or the law.

If a charitably minded settlor has concerns about providing for the needs of children or other family members, or if a settlor would otherwise opt to direct more of his or her estate to family members if not for the associated estate and GST tax liability, a charitable remainder trust may not be a good fit. If the charitable trust is to qualify for the marital deduction, the surviving spouse must be the sole non-charitable beneficiary, so there is no option to divert funds from the trust to any other person if the need or opportunity to do so arises. On the other hand, a testamentary power of appointment over a QTIP trust can give the surviving spouse the flexibility to make adjustments while still providing for charity to be the ultimate taker (and thus secure an offsetting charitable deduction for the surviving spouse's estate to the extent of the amount actually passing to charity) if the surviving spouse determines that an exercise of the power of appointment is unnecessary.

c) Distributions

A CRAT will provide the surviving spouse with regular payments of a fixed amount based upon the fair market value of the property that initially passes to the trust, while a CRUT will provide the surviving spouse with regular payments of a fixed percentage of the fair market value of the trust assets, as determined on an annual basis.[65] In either case, the parameters for distributions are set upon the creation of the trust and are not subject to change.

At a minimum, a QTIP trust must provide for the distribution of all of the trust income to the surviving spouse, but the settlor also has the option to provide for distributions of principal, whether for the surviving spouse's health, support, or otherwise. By authorizing the distribution of principal under certain circumstances, the settlor of a QTIP trust can safeguard the surviving spouse against financial insecurity due to an unexpected event such as protracted illness or disability. This degree of flexibility is simply not available with a CRAT or a CRUT. If the annuity or unitrust payment is insufficient to provide for the surviving spouse's needs, he or she will need to look elsewhere for support.

Distributions from a charitable remainder trust cannot exceed the unitrust or annuity amount, even if the surviving spouse has a legitimate need. In the case of a settlor who is concerned about

[64] Rev. Rul. 76-7, 1976-1 C.B. 179.
[65] I.R.C. §§ 664(d)(1)(A), 664(d)(2)(A).

the surviving spouse receiving an excessive amount of trust distributions, the inherent limitations of a charitable remainder trust may be perceived as a strength. In the case of a CRAT, the settlor will know the exact amount of distributions that the surviving spouse will be entitled to receive on an annual basis. In the case of a CRUT, the settlor could fund it with carefully chosen assets that he or she expects will experience only moderate growth, which will allow the settlor to know with reasonable certainty what the distributions may look like over time.

A private letter ruling from 2011 illustrates the potential creative planning opportunities that may exist with charitable remainder trusts. In the request, the taxpayer desired to amend a revocable trust to provide for (among other things) the creation of a CRUT upon taxpayer's death.[66] The terms of the CRUT provided for one-fifth of the unitrust amount to be distributed to the surviving spouse, while an independent trustee was given the discretion to determine the manner in which the surviving spouse and the designated charity were to share in the remaining four-fifths of the unitrust amount. In the event of the surviving spouse's remarriage, the spouse's share of the annual distributions would be limited to one-fifth of the unitrust amount, with the remainder passing to the designated charity.[67] The Service ruled that so long as the other requirements of Code section 664 were satisfied, the terms of the CRUT as proposed would qualify for both the marital and the charitable estate tax deductions.

Presumably, the settlor of a CRUT with terms similar to the one described in the private letter ruling could provide a statement of intent or some other guidelines for the independent trustee to consider when determining how to distribute the discretionary portion of the unitrust amount. This arrangement could be a good solution for a settlor who wants to adequately provide for the surviving spouse while still maximizing the amount that will pass to charity. The concept of limiting distributions to the surviving spouse in the event of his or her remarriage is also likely to appeal to many settlors.[68] This degree of flexibility is not available in the case of a general power of appointment trust or a QTIP trust, which must provide the surviving spouse with the required distributions of trust income for the remainder of that spouse's lifetime, regardless of circumstances.

D. The Estate Trust

Aside from the trusts already described above, the only other trust that qualifies for the marital deduction is the estate trust. The estate trust is the only type of martial trust that does not require annual income distributions to the surviving spouse during his or her lifetime. Instead, the income from an estate trust may be paid to the surviving spouse for life or for a term of years (whether on a discretionary or mandatory basis) or accumulated and added to principal so long as the full balance of trust property is paid to the surviving spouse's estate at his or her death.[69]

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[66] I.R.S. Priv. Ltr. Rul. 201117005 (April 29, 2011). As a reminder, a taxpayer cannot rely on a private letter ruling obtained by another individual. However, private letter rulings do reflect the Service's current position on an issue. A taxpayer who is interested in utilizing this structure should consider obtaining his or her own private letter ruling.

[67] As a caveat, the ruling indicated that the CRUT could not limit the surviving spouse to one-fifth of the distribution in any year (whether remarried or single) to the extent the amount distributable to her would otherwise be considered "de minimis under the facts and circumstances." The Service did not explain what it would consider to be a "de minimis" amount.

[68] Note that the period during which the unitrust amount is payable cannot be subject to termination by a condition subsequent such as remarriage. I.R.S. Priv. Ltr. Rul. 8117098 (Jan. 29, 1981).

[69] Treas. Reg. § 20.2056(c)-2(b)(1)(i) - (iii).

If the settlor wants to restrict the surviving spouse's right to receive income distributions, or if the settlor simply prefers that income distributions be made pursuant to a discretionary standard, the estate trust will be the settlor's only option for qualifying for the marital deduction. An estate trust may also be a good option if the settlor does not want to subject a non-income producing asset to the power to compel the conversion of unproductive property that would otherwise be granted to the surviving spouse over a general power of appointment trust or a QTIP trust (as discussed in more detail in section III.B below).

The use of an estate trust is subject to some distinct disadvantages. If the estate trust is designed to accumulate trust income, that income will be subject to the compressed income tax brackets for trusts rather than be taxable to the surviving spouse at the individual level. Much like a general power of appointment trust, the estate trust also puts the surviving spouse in control of the ultimate disposition of the trust assets, which is an unacceptable result for many settlors. Finally, because the estate trust assets must be paid to the surviving spouse's estate at his or her death, they will be subject to the claims of creditors at that time.

III. SPOUSAL RIGHT TO INCOME

In order for a general power of appointment trust or a QTIP trust to qualify for the marital deduction, the surviving spouse must be entitled to all of the trust income, on an annual or more frequent basis, for the entirety of his or her lifetime.[70] Satisfying the "all income" requirement may seem simple enough at first glance, but a closer look soon reveals that it is a rule with many facets and a number of potential pitfalls. The remainder of this section will explore the definition of "income," what a trust's terms must provide to fully comply with the requirements established under the Code and Regulations, and how to avoid potential problems with compliance or otherwise.

A. Defining Income

The surviving spouse is considered to have the requisite entitlement to trust income if that spouse has "substantially that degree of beneficial enjoyment of the trust property during her life which the principles of the law of trusts accord a person who is unqualifiedly designated as the life beneficiary of a trust."[71] If the surviving spouse has been designated as the sole income beneficiary of the trust for the remainder of his or her lifetime the trust will typically meet this standard, unless the terms of the trust or the surrounding circumstances "evidence an intention to deprive the spouse of the requisite degree of enjoyment."[72] As is discussed in more detail below, the Regulations imply that the sort of trust terms or "surrounding circumstances" that could be seen as disqualifying include any requirement that income be accumulated or funding the trust with unproductive property without granting the spouse the power to compel the trustee to make that property productive.

A surviving spouse's income interest will generally qualify "if the spouse is entitled to income as determined by applicable local law that provides for a reasonable apportionment between the

[70] I.R.C. §§ 2056(b)(5), 2056(b)(7)(B). Note that Treas. Reg. § 20.2056(b)-7(d)(2) provides that the principles of Treas. Reg. § 20.2056(b)-5(f) are applicable in determining whether the surviving spouse has a qualifying income interest for life for the purposes of Code section 2056(b)(7).
[71] Treas. Reg. § 20.2056(b)-5(f)(1).
[72] *Id*.

income and remainder beneficiaries of the total return of the trust."[73] Alternatively, the terms of the trust instrument may supply the necessary terms, whether as a substitute for or in the absence of a state law provision.[74]

The Regulations further require that consideration be given to the allocation of receipts and expenses between income and principal in conjunction with the nature, productivity, and expected receipts of the trust assets.[75] If the terms of the trust represent a significant deviation from the traditional standards of income and principal allocation (e.g., a provision that provides that ordinary income and dividends are principal), the spouse's income interest is unlikely to qualify.[76] That said, even if the terms of the trust use a slightly unconventional approach, the spouse's entitlement to income will still qualify so long as the composition of trust assets coupled with the trust management provisions demonstrate that the spouse will have the substantial enjoyment during his or her lifetime that is required by the Code.[77] In the absence of any terms of the trust instrument to the contrary, the Texas Uniform Principal and Income Act ("UPIA") will govern the allocations to trust income and principal for a Texas marital trust.[78]

1. Income Accumulation and Distributions

The spouse's interest in trust income will fail to meet the standards established by the Regulations if there is any requirement that income be accumulated, or if any person other than the surviving spouse has the discretion to direct the accumulation of income.[79] The practical effect of this provision is that the trustee cannot be given any discretion over the distribution of trust income. This is because any trustee's discretionary exercise of a power to distribute only a part or none of the trust income would inherently result in the accumulation of trust income.[80] A trust that grants the trustee discretion with regard to income distributions will still fail to qualify if the surviving spouse is the trustee given that there is no guarantee that the surviving spouse will remain the trustee for the duration of his or her lifetime.[81]

Although the trustee may not have any discretion with regard to the distribution of income, the surviving spouse is not actually required to receive the trust income to satisfy the "all income" test.[82] All that is required is that the spouse "have such command over the income that it is virtually hers."[83] For instance, if the spouse has the right to require the trustee to distribute all of trust income to himself or herself, that right alone will satisfy the requirements of Code sections 2056(b)(5) or (b)(7), even if the income that is not demanded by the spouse is accumulated and added to principal.[84] Nevertheless, most practitioners use a more conventional approach in drafting marital

[73] *Id*.
[74] Treas. Reg. § 20.2056(b)-5(f)(2).
[75] Treas. Reg. § 20.2056(b)-5(f)(3).
[76] Treas. Reg. §§ 1.643(b)-1, 20.2056(b)-5(f)(1).
[77] Treas. Reg. § 20.2056(b)-5(f)(3). This section of the Regulations uses the example of a trust provision that provides for receipts such as rents, ordinary cash dividends, and interest to be allocated to income and stock dividends and proceeds from the conversion of trust assets being allocated to principal.
[78] Tex. Prop. Code § 116.004.
[79] Treas. Reg. § 20.2056(b)-5(f)(7).
[80] *Davis v. Comm'r*, 394 F.3d 1294 (9th Cir. 2005); I.R.S. Tech. Adv. Mem. 200505022 (Feb. 4, 2005).
[81] *Davis*, 394 F.3d at 1302; *Estate of Ellingson v. Comm'r*, 964 F.2d 959, 962 (9th Cir. 1992).
[82] Treas. Reg. § 20.2056(b)-5(f)(8).
[83] *Id*.
[84] *Id*., I.R.S. Priv. Ltr. Rul. 9030001 (March 3, 1990).

trusts and include a requirement that the trustee distribute all of the trust income to the surviving spouse, whether annually or at more frequent intervals.

2. Inception and Termination of the Spouse's Right to Income

The administration of a decedent's estate often takes time, particularly in the case of a taxable estate. Section 20.2056(b)-5(f)(9) of the Regulations provides that an interest will not fail to qualify for the marital deduction "merely because the spouse is not entitled to the income from estate assets for the period before distribution of those assets by the executor," unless the executor is authorized to unreasonably delay that distribution. There is no clear guidance on what constitutes an unreasonable delay, and the standard of reasonableness will likely be highly dependent on the facts and circumstances surrounding a particular estate. In at least one instance, the Service has indicated that a multiyear delay in funding due to the nature of the estate assets and a lengthy estate administration would not affect qualification for the marital deduction.[85]

Absent a provision to the contrary in the trust instrument, for Texas law purposes a surviving spouse's right to receive trust income begins as of the date of the deceased spouse's death.[86] On the opposite end of that spectrum, the surviving spouse's right to receive trust income ends on the day before the surviving spouse dies.[87] In the case of a QTIP trust, an income interest will not be disqualified if the trust instrument does not provide for the distribution to the surviving spouse or to his or her estate of the trust income that accrues between the date of the last distribution and the date of the surviving spouse's death.[88] However, this portion of trust income is included in the surviving spouse's gross estate for estate tax purposes.[89]

B. Spouse's Rights as to Unproductive Property

A trust that consists substantially of unproductive or non-income producing property will almost certainly fail to qualify for the marital deduction if the trustee has an unqualified power (or obligation) to retain that property.[90] To prevent that outcome, nearly all marital trusts provide the surviving spouse with the power to compel the trustee to either convert unproductive property into income producing property or to otherwise take such action as will be necessary to ensure that spouse has the requisite beneficial enjoyment of the trust property. A detailed analysis of the Regulations reveals the full breadth of potential options for addressing issues relating to unproductive trust property. Each of these options is discussed in more detail below.

1. Power to Compel the Trustee to Take Action

If a marital trust consists substantially of unproductive property, the trust may still qualify for the marital deduction if the applicable rules governing the administration of the trust require, or permit the surviving spouse to require, that the trustee either make that property productive or convert that property into income producing property within a reasonable time.[91] With that concept in mind, it may be helpful to consider the meaning of the term "unproductive property." The

[85] I.R.S. Priv. Ltr. Rul. 9125016 (March 21, 1991).
[86] Tex. Prop. Code § 116.101(b)(2).
[87] Tex. Prop. Code § 116.101(d).
[88] Treas. Reg. § 20.2056(b)-7(d)(4).
[89] Treas. Reg. § 20.2044-1(d)(2).
[90] Treas. Reg. § 20.2056(b)-5(f)(4) – (5).
[91] Treas. Reg. § 20.2056(b)-5(f)(3).

Regulations do not provide a definition, but a few examples of property that the Service has found to be unproductive include artwork,[92] timberland that was unlikely to be harvested,[93] and real estate subject to significant depreciation reserves.[94] It can be reasonably inferred that assets such as undeveloped real estate and stock in a closely held corporation or a limited partnership interest that does not have a history of reliably receiving distributions would also be at risk of being classified as unproductive if held by the trustee of a marital trust.

In some instances, it may be difficult if not impossible for the trustee to make a particular interest in property productive. In the case of a minority voting or limited partnership interest, the trustee is unlikely to have the right to force more distributions. The trustee may be able to make real or tangible personal property productive by leasing it to a third party, but even then, the return on investment relative to the overall value of the property may not rise to a level that would be considered "productive." As a result, assets that have the best potential to be made productive by a trustee are likely cash, marketable securities, and other similarly liquid investments.

If there is no feasible way for the trustee to make the property productive, then the trustee also has the option to convert the property into income producing property. This process would typically involve the trustee selling all or a portion of the unproductive property and investing the sale proceeds in other property that will produce an appropriate level of income. It is a simple idea in theory that can be much more difficult in execution, particularly for the trustee.

Some property, like residential real estate, often has an accessible marketplace where the trustee can find and negotiate with willing buyers with relative ease. There are also avenues available for selling less common assets such as mineral interests, commercial real estate, and high value collectibles, but there are likely to be fewer eligible buyers and it may be more difficult for the trustee to determine what constitutes a fair price. Selling a marital trust asset to the first willing buyer who comes along may not be in the best interests of the surviving spouse if the offered price is not reflective of fair market value. It may be equally or even more problematic from the perspective of the remainder beneficiaries who are relying on the trustee to preserve trust principal for their potential future benefit.[95]

In order to ensure that the trustee sells the unproductive property in a manner that is consistent with the fiduciary duties that it owes to the trust beneficiaries, it may be necessary to obtain a third-party appraisal to gain a better understanding of its fair market value. In the case of unique and less marketable assets, another thing the trustee may need is time. It may be impossible to sell the asset in weeks, or even months, without essentially holding a fire sale. The Regulations provide that the trustee is only required to convert the unproductive property "within a reasonable time."[96] The Regulations do not offer any concrete guidance on what a "reasonable" amount of time may be, but presumably any length of time could be perceived as reasonable so long as the trustee acts with an appropriate degree of diligence and haste to sell the asset at a favorable price.

In an even more limited number of cases, the trustee may be tasked with selling an asset that has extremely limited marketability. This situation will most often arise in the case of stock in a

[92] I.R.S. Tech. Adv. Mem. 9237009 (Sept. 11, 1992).
[93] I.R.S. Tech. Adv. Mem. 9717005 (April 25, 1997).
[94] I.R.S. Priv. Ltr. Rul. 9125016 (March 21, 1991).
[95] Absent a provision to the contrary in the trust instrument, a Texas trustee generally owes a duty to administer the trust fairly and impartially as to both income and remainder beneficiaries. Tex. Prop. Code § 116.004(b).
[96] Treas. Reg. § 20.2056(b)-5(f)(4).

closely held corporation or a limited partnership interest. These types of interests are often subject to transfer restrictions that drastically limit the pool of potential buyers. Even in the absence of such restrictions, the reality may be that there are no willing buyers at all, particularly if the other owners are all family members or were long-time associates of the deceased spouse. In this scenario, the trustee may need to rely upon the third option provided by the Regulations.

If the trustee cannot make an asset productive or convert it to income producing property, the Regulations offer a third option: the trustee may provide the spouse with the required beneficial enjoyment by making payments to the spouse out of other assets of the trust.[97] For example, consider a hypothetical trust that consists substantially of a limited partnership interest but also holds publicly traded stocks and bonds. Instead of selling or disposing of the partnership interest, the trustee could potentially sell some of the stock and distribute a portion of the resulting cash to the spouse. Perhaps the trustee could obtain a line of credit secured by the limited partnership interest and use those funds to increase the distributions to the spouse. The trustee could even distribute a portion of the partnership interest directly to the spouse, assuming that the spouse is a permitted transferee.

The trustee will be able to make the most effective use of this option if local law or the terms of the trust provide the trustee with the power to adjust between income and principal. If a trust's portfolio is well invested on the whole but produces either too much or too little income, the power to adjust allows the trustee to remedy that imbalance. If the trustee of a marital trust has this power, the trustee can potentially use it to shift principal to income for distribution to the surviving spouse.

2. The Statutory Solution

If the trust instrument is silent as to the trustee's obligations or the spouse's rights to ensure that the spouse has the requisite degree of beneficial enjoyment from the trust property, the terms of the Texas Trust Code may fill that gap. If a marital trust's assets consist substantially of property that does not provide the spouse with sufficient income, and if the trustee's exercise of the power to adjust has proven insufficient to provide the surviving spouse with the beneficial enjoyment required to qualify for the marital deduction, then the spouse may: (i) require the trustee to make property productive of income, (ii) convert property within a reasonable time, or (iii) exercise the power to adjust.[98] The Trust Code further provides that the trustee may decide which action or combination of actions to take.[99]

C. Addressing Potential Problems in Advance

As the prior discussion illustrates, the spousal right to the income can present problems both during drafting and upon administration. By anticipating these potential problems, practitioners may be able to implement solutions that will prevent them from arising in the first place.

1. Marital Deduction Savings Clauses

The Service and the courts have demonstrated a willingness to rely on marital deduction savings clauses to preserve the marital deduction in cases involving the inadvertent inclusion of a

[97] Treas. Reg. § 20.2056(b)-f(5).
[98] Tex. Prop. Code § 116.176(a).
[99] *Id*.

trust term that might otherwise jeopardize its availability.[100] It is often prudent to include a clear expression of the settlor's intent that the marital trust shall qualify for the marital deduction,[101] along with a broader statement regarding the construction and interpretation of other trust provisions. For example:

> "Notwithstanding any provision contained in this instrument to the contrary, the trustee shall have no power, right, duty or obligation that will result in the failure of the property passing to the Marital Trust to qualify for the marital deduction allowable under the Code (and shall be obligated to undertake such additional responsibility as shall be necessary to ensure such qualification)."

A savings clause may help ensure that a trust instrument will be construed in the most favorable way possible, and it may (but should not be counted upon to) overcome the inclusion of a trust term that would otherwise disqualify the trust for the marital deduction by giving the trustee a basis for arguing that the inadvertent disqualifying term and the savings clause, when read together, evidence an ambiguity that necessarily must be resolved based upon the clarity of the settlor's objectives for the trust reflected in the savings clause.[102] Even with the inclusion of a savings clause, drafting a marital trust must still be done with the upmost care.

2. Incapacity Issues

Most trusts include a facility of payment clause that authorizes the trustee to make trust distributions to a third party on behalf of a beneficiary who is incapacitated. The clause may allow distributions to be made to an agent, guardian, custodian, or any other person or entity who is well positioned to apply the distribution for the benefit of the incapacitated beneficiary. Revenue Ruling 85-35 confirms that a marital trust may still qualify for the marital deduction if it includes a facility of payment clause that allows the trustee to either distribute trust income to a relative or a court appointed representative for the spouse or spend the income directly for the spouse's benefit in the event of that spouse's legal disability.

Care must be taken when drafting any other trust provision that addresses incapacity. For instance, a trust provision that terminates the surviving spouse's right to mandatory distributions of trust income upon his or her incapacity will disqualify that trust for the marital deduction, even if the spouse never loses capacity.[103] A similar result was reached in the case of a trust that provided the surviving spouse with an unlimited right to withdraw trust property that terminated upon incapacity.[104]

3. Planning for the Blended Family

The QTIP trust is sometimes used as a planning vehicle for blended families because it enables a settlor to provide for his or her surviving spouse for the remainder of that spouse's lifetime while also preserving principal for the eventual benefit of the settlor's descendants from a prior relationship. Even if this planning works well for tax purposes, there may be a heighted potential

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[100] Rev. Rul. 75-440, 1975-2 C.B. 372; *Estate of Ellingson*, 964 F.3d at 960.

[101] In the case of a QTIP trust, it may be appropriate to add that the settlor only intends for the subject trust to qualify for the marital deduction to the extent that the settlor's executor opts to make the QTIP election so as not to create confusion in the event of a partial election.

[102] *See*, *e.g.*, *Davis*, 394 F.3d at 1302; I.R.S. Tech. Adv. Mem. 200234017 (Aug. 23, 2002).

[103] *Estate of Tingley v. Comm'r*, 22 T.C. 402 (1954), *aff'd sub. nom.*, *Starrett v. Comm'r*, 223 F.2d 163 (1st Cir. 1955).

[104] I.R.S. Tech. Adv. Mem. 9644001 (July 3, 1996).

for conflict between the surviving spouse and the remainder beneficiaries, particularly when it comes to the complexities and nuance involved in satisfying the "all income" test. The spouse and remainderman may disagree as to the allocation of receipts and expenses to income and principal, the investment strategy for trust assets, and whether the amount of income produced by the trust assets is sufficient to provide the spouse with the requisite degree of beneficial enjoyment.

The situation becomes even more complex if the marital trust will hold a concentration in an asset that is important to the family but does not produce much income, such as an interest in a family business or a ranch. Assuming that the surviving spouse has the authority to force the trustee to make the property productive or convert it into income producing property, the end result could be very unpleasant for all involved.

If the spouses recognize that the potential for this type of conflict exists, it may be preferable to pass certain assets directly to the settlor's children and to provide for the spouse in other ways, such as through life insurance. But if the settlor decides to forgo those options in favor of a marital trust, there are steps that the settlor can take during life to maximize the potential for success:

- Adopt Appropriate Regulations on Entity Distributions During Life. To the extent that the settlor has the authority to do so, the settlor could amend the governing documents for any relevant entity to implement a distributions policy designed to ensure that the entity will retain sufficient funds as working capital and for the expansion of operations while also providing an appropriate level of distributions to meet the intended tax planning objectives.
- Use Rights of First Refusal. If the settlor knows that the marital trust is likely to hold a significant interest in an asset that may not produce sufficient income, the trust must provide the surviving spouse with the power to compel the trustee to make that particular interest productive, or to convert it to income producing property. However, the trust instrument could further provide that in the event that the spouse exercises that power, the trustee is to first provide certain of the settlor's family members, business associates, or any other appropriate parties with the right to purchase the interest at its fair market value, as determined by an independent appraisal.[105] This type of provision must be precisely tailored so that (i) it will only be triggered in the event that a sale is serving a valid administrative purpose, such as ensuring that the surviving spouse's right to income is met, and (ii) the sales price will represent fair market value.[106] Note that a purchase option of this nature could also be made part of an independent buy-sell agreement.
- Be Specific About Settlor's Intent and Spouse's Rights. It is important to include a carefully drafted property conversion clause to ensure that the trustee will have the full range of possible options to remedy a situation in which property is unproductive. Sometimes these clauses focus on the spouse's rights to compel the trustee to make property productive or to convert it to income producing property but neglect to provide the trustee with the option to make payments to the spouse out of other assets of the trust. It may also be helpful to compare the terms of the clause to the statutory provisions of local

[105] *See* I.R.S. Priv. Ltr. Rul. 199951029 (Dec. 27, 1999), in which the Service determined that a trust with this type of arrangement for shares of stock in a corporation would qualify for the marital deduction.

[106] *See Estate of Rinaldi v. United States*, 38 Fed. Cl. 341 (1997), *aff'd*, 178 F.3d 1308 (Fed. Cir. 1998). In this case, decedent's shares of stock passed to the marital trust of which decedent's son was appointed the trustee. The terms of the trust provided that if the son stopped being involved in the day-to-day management of the company, the trustee was to sell the shares to son for their book value. The court ruled the trust did not qualify for the marital deduction on account of this arrangement.

law to determine the extent (if any) to which the statute may apply in conjunction with the clause.

D. The Unitrust Option

As noted throughout the discussion in this section, the trustee of a marital trust must invest and manage trust assets in a way that ensures that the surviving spouse will receive the requisite income distributions while also maintaining sufficient principal to mollify the remainder beneficiaries. This task often becomes even more challenging if the settlor has a blended family or if the marital trust is funded with a significant concentration in one or more assets of a particular type. Under these circumstances, a marital unitrust may be able to offer a solution.

A surviving spouse's income interest will generally qualify for the marital deduction "if the spouse is entitled to income as determined by applicable local law that provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust and that meets the requirements of § 1.643(b)-1 of this chapter."[107] Section 1.643(b)-1 of the Regulations provides that this standard for "reasonable apportionment" may be satisfied by a state statute providing that the income of a trust can be determined by using a unitrust amount between three and five percent of the fair market value of the trust assets, as determined annually or based upon a multiyear average.[108] As a result, an interest in a unitrust will qualify for the marital deduction if said interest is authorized by local law and all other statutory and regulatory requirements are met.

Section 116.007 of the Texas Trust Code empowers Texas settlors to take advantage of the unitrust option. The statute provides that a distribution of the unitrust amount will be considered a distribution of all of the trust income.[109] The unitrust amount is defined as "an amount equal to a fixed percentage of not less than three or more than five percent per year of the net fair market value of the trust's assets, valued at least annually."[110] The unitrust amount may be based on the net fair market value of the trust's assets in one year or more than one year.[111]

A unitrust may serve to ease tensions between the surviving spouse, remainder beneficiaries, and trustee. A unitrust essentially eliminates a trustee's distribution discretion, so there should be no disagreements about the amount of distributions to the surviving spouse. A unitrust may also reduce the potential for arguments over the trustee's investment strategy. If the value of the trust property is growing, all of the parties will be happy, regardless of whether that growth is attributable to income or appreciation of principal.

As is the case with any planning option, there are also potential downsides to using a unitrust. First, the trustee will have no way to unilaterally adjust the unitrust amount, even if that amount has become inappropriate in light of changes in the market or surviving spouse's financial needs. It is also important to keep in mind that the unitrust assets will need to be valued at least annually. This may be a difficult (and expensive) task if the trust holds closely held entity interests, commercial real estate, mineral interests, collectibles, or any other assets that may require a third-party appraisal to value. These types of assets will also present a problem if at any point the trustee

[107] Treas. Reg. § 20.2056(b)-5(f)(1).
[108] Treas. Reg. § 1.643(b)-1.
[109] Tex. Prop. Code § 116.007(c).
[110] Tex. Prop. Code § 116.007(b)(2).
[111] *Id*.

must begin making distributions of principal to satisfy the unitrust amount. These factors should all be taken into consideration before including a marital unitrust as part of a spouse's estate plan.[112]

IV. PLANNING WITH INTER VIVOS QTIPS

Although it is often overshadowed by its testamentary counterpart, an inter vivos QTIP election is available in conjunction with lifetime marital deduction planning.

A. Basic Requirements

The unlimited marital deduction applies to any interest in property that a donor transfers by gift to his or her spouse so long as (i) that spouse is a U.S. citizen, and (ii) the interest is not a nondeductible terminable interest.[113] Although there is no marital deduction for gifts made to a donee-spouse who is not a U.S. citizen, there is an annual exclusion available to a donor who makes a gift to a non-citizen spouse.[114] This annual exclusion amount is equal to $100,000, as adjusted for inflation.[115] For 2024, the annual exclusion amount is $185,000.[116]

As was previously mentioned in connection with the estate tax marital deduction, a terminable interest is defined as any interest in property that "will terminate or fail on the lapse of time or on the occurrence or the failure to occur of some contingency."[117] If the donor gifts his or her spouse a terminable interest in property that will be subject to the possession or enjoyment of any other person (including the donor) upon the failure or termination of that interest, it will generally not qualify for the marital deduction.[118] This general rule is subject to the exceptions that are detailed below.

1. Joint Interests

An interest transferred to the donee-spouse as the sole joint tenant with the donor or as tenant by the entirety will qualify for the marital deduction even though the donor may possess or enjoy the property after the termination of the interest by virtue of being the surviving spouse.[119]

2. Life Estate with a Power of Appointment

Code section 2523(e) provides that an interest that is gifted by the donor-spouse to or for the benefit of the donee-spouse will qualify for the marital deduction if it satisfies two main criteria: (i) the donee-spouse must be entitled to all of the income from the interest for life, payable at least annually, and (ii) the donee-spouse must hold a general power of appointment over the interest, exercisable in favor of the donee-spouse or his or her estate. This provision is essentially the gift tax counterpart of Code section 2056(b)(5). As a result, the same limitations and requirements that

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[112] For a further discussion of martial unitrusts, *see* Katherine C. Akinc, *Save the QTIPs for your Ears: Drafting Alternative Marital Trusts*, State Bar of Texas Estate Planning and Probate Drafting Course, Houston, Texas, October 26-27, 2017.
[113] I.R.C. § 2523.
[114] I.R.C. § 2523(i)(2).
[115] *Id.*; I.R.C. § 2503(b).
[116] Rev. Proc. 2023-34, 2023-48 I.R.B. 128.
[117] Treas. Reg. § 25.2523(b)-1(a)(3).
[118] I.R.C. § 2523(b); Treas. Reg. § 25.2523(b)-1(b).
[119] I.R.C. § 2523(d); Treas. Reg. § 25.2523(d)-1.

are described in section II.C.2 in this article are equally applicable to an inter vivos general power of appointment trust.[120]

3. Inter Vivos QTIP

An interest in property that is gifted by the donor-spouse to or for the benefit of the donee-spouse will qualify for the marital deduction as a qualified terminable interest if that interest (i) is transferred by the donor-spouse, (ii) provides the donee-spouse with a qualifying income interest for life, and (iii) is subject to the election under Code section 2523(f)(4).[121] Code section 2523(f)(3) provides that rules similar to those that apply to clauses (ii), (iii), and (iv) of Code section 2056(b)(7)(b) also apply to an inter vivos QTIP. Most notably, this provision confirms that a "qualifying income interest for life" must meet the same standards for both a testamentary QTIP and an inter vivos QTIP. As a result, the discussions regarding a spouse's income interest in sections II.C.4 and III above are equally applicable to an inter vivos QTIP.[122]

4. Charitable Remainder Trust

Code section 2523(g) provides that an interest passing to a qualified charitable remainder trust will qualify for the marital deduction if the donee-spouse is the only non-charitable beneficiary of that trust. The principles discussed in section II.C.5 of this article regarding the marital deduction under Code section 2056(b)(8) are equally applicable here.

B. Various Uses of Inter Vivos QTIP Trusts

The basic structure of an inter vivos QTIP trust is typically the same as its testamentary counterpart. The trustee must distribute all of the trust income to the donee-spouse at least annually but may also be authorized to distribute principal if that is desirable.[123] Upon the death of the donee-spouse, the remaining trust property will be includible in the donee-spouse's gross estate and will pass to the remainder beneficiaries as designated in the trust instrument.[124] Alternatively, if the donee-spouse holds a testamentary power of appointment over the trust, the remaining trust property will pass to the designated appointees to the extent that power is exercised. The remainder of this section discusses the circumstances in which it might be beneficial to create an inter vivos QTIP trust.

1. Equalization of the Spouses' Estates

An inter vivos QTIP trust can be used to effectively equalize the taxable estates of spouses who have disparate amounts of wealth. For example, assume H has assets of $5 million, while W has assets of $15 million.[125] If H were to predecease W, the value of his gross estate would be too low to consume the full balance of his applicable exclusion amount. W could fund an inter vivos QTIP trust with $5 million without using any of her applicable exclusion amount. The inter vivos QTIP trust will be includible in H's gross estate pursuant to Code section 2044, resulting in H's

[120] *See* Treas. Reg. § 25.2523(e)-1.
[121] I.R.C. § 2523(f)(2).
[122] Treas. Reg. § 25.2523(f)-1(b), (c).
[123] Treas. Reg. § 25.2523(f)-1(c)(1)(iv).
[124] I.R.C. § 2044(a). See section VI herein for further discussion.
[125] For the purposes of this example, assume that the applicable exclusion amount is equal to $10 million for ease of calculation and illustration.

gross estate having a value of $10 million. Thus, the full balance of H's estate is shielded from estate tax by H's applicable exclusion amount.

A similar result could be achieved with an outright gift, but the inter vivos QTIP provides advantages that an outright gift does not. First, the trust structure will allow the donor-spouse to retain a degree of control over the disposition of the trust assets. Aside from the provisions that the donor-spouse must include to qualify the trust for the marital deduction, he or she will be able to dictate the trust terms governing its management and administration, including with regard to principal distributions and the disposition of trust property following the donee-spouse's death.

The donor-spouse can also serve as trustee of the trust (provided that his or her powers in that role do not amount to a general power of appointment) and continue to manage the gifted property for the benefit of the donee-spouse. The trust will also be protected from the creditors of both the donor and donee spouses, although the income distributions will lose that protection as they are made to the donee-spouse. Finally, consider that if the donor-spouse makes an outright gift to the donee-spouse for equalization purposes, that gift will be the donee-spouse's separate property and would not be subject to division in the event of divorce. Conversely, if the gift were made in trust, the donor-spouse may be able to retain some degree of control over the trust assets by continuing to serve as trustee after the divorce, and the trust assets would still pass to the donor-spouse's designated remainder beneficiaries at the donee-spouse's death.

As an alternative to equalizing the value of their estates, spouses now have the option to rely on portability to preserve a deceased spouse's unused exclusion amount. As compared to equalization through an inter vivos QTIP, there are a few disadvantages to relying on portability. For instance, the deceased spousal unused exclusion amount (the "DSUE") can sometimes be lost. If the surviving spouse remarries and is later predeceased by his or her new spouse, the surviving spouse will no longer be able to use the DSUE amount stemming from a prior deceased spouse.[126] Another potential problem is that portability does not extend to the GST tax exemption, as is discussed in the next section.

2. Leverage of GST Tax Exemption

An inter vivos QTIP trust can be an effective vehicle for leveraging the GST tax exemption amount of the donor-spouse or the donee-spouse. Consider the example in the prior section. If W never creates the inter vivos QTIP and H dies first, half of his GST tax exemption will simply be lost because his estate will not have enough property to absorb it. By creating the trust, W will have increased the value of H's gross estate so that it will have sufficient property to potentially absorb the full balance of his remaining GST tax exemption. Because portability does not apply to the GST tax exemption amount, an inter vivos QTIP trust is a superior option for GST tax planning.

The donor-spouse also has the option of allocating his or her own GST tax exemption to an inter vivos QTIP trust through a reverse QTIP election, as described in more detail in section V.D below. This option may work particularly well for a donor-spouse who has used all of his or her gift and estate tax exclusion amount but still has GST tax exemption remaining, as it represents a rare opportunity to make a large lifetime transfer of wealth without incurring any gift tax.

[126] *See* I.R.C. § 2010(c)(4)(B); Treas. Reg. § 20.2010-1(d)(5).

3. Donor-Spouse as a Beneficiary

One of the most attractive features of the inter vivos QTIP trust is that the donor-spouse can become a beneficiary of the trust after the donee-spouse's death (assuming, of course, that the donor-spouse is the surviving spouse). This result is typically achieved by providing that upon the donee-spouse's death, an amount of trust property equal to the donee-spouse's applicable exclusion amount will to pass to a bypass trust, with any remaining amount passing to a QTIP trust to avoid estate tax. The bypass trust can provide for the donor-spouse along with descendants or any other appropriate parties. If created, the QTIP trust must comply with the usual requirements and would provide income distributions to the donor-spouse for the remainder of his or her lifetime.

Even though the donor-spouse is the settlor of the bypass trust created in this scenario, the trust will not be included in his or her estate. Code section 2523(f)(1)(B) provides that no part of an inter vivos QTIP trust shall be considered as having been retained by the donor-spouse or transferred to any person other than the donee-spouse. Furthermore, the donee-spouse will be considered the transferor of the trust assets for estate and GST tax purposes due to the inclusion of those assets in his or her estate.[127] In accordance with the foregoing, the Regulations confirm that the donor-spouse's subsequent beneficial interest in the trust is not subject to estate inclusion under Code section 2036 or Code section 2038.[128] The Texas Trust Code also confirms that the trust will have spendthrift protection.[129]

It is important to note that it is unclear under the Code and Regulations whether the donor-spouse can have a limited power of appointment over the bypass trust created subsequent to the donee-spouse's death. Code section 2523(b)(2) provides that a terminable interest will not qualify for the marital deduction if the donor-spouse has a power of appointment over the interest.[130] This provision could be construed to encompass a power of appointment that does not take effect until after the donee-spouse's death. If that interpretation is correct, then an inter vivos QTIP trust would not qualify for the marital deduction if the donor-spouse is granted a power of appointment over the bypass trust. A number of commentators contend that the power will not create a Code section 2523(b)(2) issue, and several private letter rulings support that position.[131] Absent further guidance from the Service, the most conservative course of action is to refrain from including a power of appointment over the bypass trust.[132]

4. Disadvantages of Inter Vivos QTIPs

Before making a gift to an inter vivos QTIP trust, the donor-spouse must also consider some of the potential disadvantages of this type of planning. The main disadvantage is that creating an inter vivos QTIP trust requires the donor-spouse to give up all of his or her rights to the trust property for the duration of the donee-spouse's lifetime. The donee-spouse will likely use some or

[127] I.R.C. § 2044(c). Note that if the donor-spouse makes a reverse QTIP election in conjunction with the initial gift to the trust, he or she will be considered the transferor for GST tax purposes.
[128] Treas. Reg. § 25.2523(f)-1(f), Examples 10 and 11.
[129] Tex. Prop. Code § 112.035(g).
[130] *See also* Treas. Reg. § 25.2523(b)-1(d).
[131] I.R.S. Priv. Ltr. Rul. 200406004 (Feb. 6, 2002); I.R.S. Priv. Ltr. Rul. 9437032 (Sept. 16, 1994).
[132] For a further discussion of this issue and other related concepts, *see* Jonathan G. Blattmachr, Mitchell M. Gans, and Diana S. C. Zeydel, *Supercharged Credit Shelter Trust*, 21 Prob. & Prop. 52 (2007), *available at* https://scholarlycommons.law.hofstra.edu/cgi/viewcontent.cgi?article=1475&context=faculty_scholarship.

all of the income distributions in a way that is mutually beneficial to both spouses, but those distributions will be the donee-spouse's separate property, so there is no guarantee of that. In addition, the income distributions must continue for the duration of the donee-spouse's lifetime, even if the couple later gets a divorce.[133]

V. MAKING THE QTIP ELECTION

An interest passing to or for the benefit of the surviving spouse in accordance with Code section 2056(b)(7) will only qualify for the marital deduction if the QTIP election is made. This section describes the requirements for making the QTIP election and the various forms that an election may take.

A. General Requirements

Following a spouse's death, the QTIP election can only be made by the deceased spouse's executor on Schedule M of the Form 706 United States Estate (and Generation-Skipping Transfer) Tax Return.[134] In this context, the term executor refers to the person or organization that is appointed, qualified, and acting within the United States within the meaning of Code section 2203.[135] An appointed executor may make the election even if the property subject to that election is not in the executor's possession.[136] If there is no appointed executor, the election may be made by any person in actual or constructive possession of the property of the decedent, such as the trustee of a revocable trust that is included in the decedent's gross estate.[137]

The election must be made on either the last estate tax return filed on or before the due date (including extensions), or if a timely return is not filed, on the first estate tax return filed after the due date.[138] For example, if the executor files an estate tax return in which the QTIP election is not made three months prior to the due date, that executor could file a subsequent return at any time on or before the due date to make the election. If no estate tax return is timely filed, it is seemingly possible to make the QTIP election on the first late filed return. Once the QTIP election is made it is irrevocable, provided that the election may be revoked or modified on a subsequent return filed on or before the due date (including extensions).[139]

The Regulations permit the executor to make a protective election if the executor reasonably believes that there is an issue as to whether an asset is includible in the decedent's gross estate or as to the amount or nature of the property the surviving spouse is entitled to receive.[140] The protective election must identify the specific asset(s) or trust to which the election applies, and it must also describe the basis for the election.[141]

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[133] Treas. Reg. §§ 25.2523(f)-1(c)(1)(i), 25.2523(e)-1(f), Example 5.
[134] I.R.C. § 2056(b)(7)(B)(v).
[135] Treas. Reg. § 20.2056(b)-7(b)(3).
[136] *Id*.
[137] *Id*.
[138] Treas. Reg. § 20.2056(b)-7(b)(4)(i).
[139] Treas. Reg. § 20.2056(b)-7(b)(4)(ii).
[140] Treas. Reg. § 20.2056(b)-7(c)(1).
[141] *Id*.

B. Partial Elections

The executor may make a partial QTIP election with respect to a fractional or percentage share of the trust property.[142] A partial election may be made pursuant to a formula,[143] which will be advisable in most cases. The formula will typically resemble one that might be used to define a bequest to the marital trust under a will or otherwise. Examples 7 and 8 from section 20.2056(b)-7(h) of the Regulations provide two different examples of a formula QTIP election.

If the bulk of the decedent's estate is directed to pass to a QTIPable trust, a partial election can be used to allocate all or a portion of the decedent's remaining estate tax exclusion amount to that trust. In fact, this scenario may arise by design. Now that portability is available to preserve the deceased spouse's unused exclusion amount, some couples may provide for the deceased spouse's entire estate to pass to a QTIPable trust and then rely on the executor to determine whether a full, partial, or no QTIP election will be most beneficial based upon the circumstances that exist at that spouse's death. This type of trust is sometimes referred to as a "one lung trust."

If a partial QTIP election is made, a trust may be divided into separate trusts to reflect the partial election if authorized under the trust instrument or local law.[144] The division of the trust must be done on a fractional or percentage basis, but the separate trusts do not have to be funded with a pro rata share of each asset.[145] A trust may only be divided if the trustee is required to divide the trust based on the fair market value of the trust as of the division date.[146]

So long as it is not expressly prohibited by the trust instrument, the Texas Trust Code authorizes a trustee to divide a trust if the result does not impair the rights of any beneficiary or adversely affect the achievement of the purposes of the original trust.[147] The trustee is further authorized to "allocate trust property among the separate trusts on a fractional basis, by identifying the assets and liabilities passing to each separate trust, or in any other reasonable manner."[148]

C. Clayton QTIP Elections

When the QTIP provisions were initially introduced by ERTA, the Service took the position that if the amount of property passing to the marital trust was contingent upon the executor making the QTIP election, then no marital deduction would be allowed. The Service eventually changed course after several courts of appeals rejected this argument, most notably in the case of *Estate of Clayton v. Comm'r*, 976 F.2d 1486 (5th Cir. 1992). In *Clayton*, the deceased spouse's estate plan provided for any portion of the residuary estate for which a QTIP election was made to pass to a marital trust, while any part of the residuary that was not subject to the QTIP election would pass to a trust for the benefit of the deceased spouse's children.[149] The executor ultimately chose to make a QTIP election as to a portion of the deceased spouse's estate, and the Fifth Circuit agreed that the QTIPed portion of the estate qualified for the marital deduction.[150] After several other

[142] I.R.C. § 2056(b)(10); Treas. Reg. § 20.2056(b)-7(b)(2).
[143] Treas. Reg. § 20.2056(b)-7(b)(2)(ii).
[144] Treas. Reg. § 20.2056(b)-7(b)(2)(ii)(A).
[145] Treas. Reg. §§ 20.2056(b)-7(b)(2)(ii)(B), 20.2056(b)-7(h), Example 14.
[146] Treas. Reg. § 20.2056(b)-7(b(2)(ii)(C).
[147] Tex. Prop. Code § 112.057(a).
[148] Tex. Prop. Code § 112.057(b).
[149] *Estate of Clayton v. Comm'r*, 976 F.2d 1486, 1488 (5th Cir. 1992)
[150] *Id*. at 1501.

courts reached a similar conclusion,[151] the Service conceded defeat and issued Regulations consistent with the decisions in *Clayton* and its progeny.[152]

In accordance with those Regulations, a will or trust may provide that property that is subject to a QTIP election will pass to a marital trust, while property that is not subject to that election will pass to any other beneficiary or trust as designated in the will or trust. In a traditional Clayton QTIP plan, the non-QTIPed property will be directed to a bypass trust, but that is not required.

A Clayton QTIP trust is similar to a one lung trust in the sense that both plans typically result in the creation of a marital trust and a bypass trust for the benefit of the surviving spouse. However, with a one lung trust, both the marital trust and the bypass trust will have the same terms, including the requirement that all income be distributed to the surviving spouse. The only difference is that the marital trust will be included in the surviving spouse's gross estate, while the bypass trust will not. With a Clayton QTIP plan, the bypass trust can have entirely different terms than the marital trust. It can limit the spouse's right to receive income distributions, provide the spouse with an inter vivos power of appointment, and include a spray power that allows for distributions to descendants.

1. Surviving Spouse as Executor

Over the years, some commentators have expressed concerns about the surviving spouse serving as the executor tasked with making a Clayton QTIP election. If the surviving spouse declines to make the full QTIP election, that inevitably results in a portion of the deceased spouse's estate passing to a bypass trust (or potentially, other beneficiaries altogether). Assuming that the bypass trust does not entitle the spouse to receive mandatory distributions of income, the concern is that the surviving spouse could be treated as having made a gift by not making a full QTIP election and thus giving up his or her right to the mandatory income distributions that he or she would have otherwise received from a marital trust.

Due to these concerns, the most conservative course of action is to name someone other than the spouse to serve as the executor. Alternatively, the spouse could serve as executor, but an independent third party could be given the sole authority to direct the surviving spouse, in his or her capacity as the executor, to make or not make the QTIP election with regard to the relevant portions of the decedent's estate.

2. Clayton QTIP or Disclaimer?

Disclaimer planning can be used to achieve similar results as a Clayton QTIP plan. The settlor's estate plan could provide for the residuary estate to pass entirely to a QTIPable trust, provided that if the surviving spouse disclaims any part of the residuary, the disclaimed property will pass to a bypass trust. The primary advantage of the disclaimer approach is that it allows the surviving spouse to determine what shares of the estate will pass to the marital and bypass trusts without the risk of there being a gift tax issue. However, a Clayton QTIP plan has several advantages over a disclaimer plan, as follows:

- Time Period to Decide. A Clayton QTIP election must be made on the estate tax return, which will be due 15 months after the deceased spouse's date of death (if an automatic six-

[151] *Estate of Robertson v. Comm'r*, 15 F.3d 779 (8th Cir. 1994); *Estate of Spencer v. Comm'r*, 43 F.3d 226 (6th Cir. 1995).
[152] Treas. Reg. §§ 20.2056(b)-7(d)(3), 20.2056(b)-7(h), Example 6.

month extension is requested). In other words, the executor will have 15 months to make a decision about the QTIP election depending on the value of the decedent's gross estate, the surviving spouse's age and financial situation, current tax laws, and any other relevant factors. In contrast, a qualified disclaimer for federal tax purposes must be made within nine months of the decedent's date of death.[153] While this window still provides the surviving spouse with an opportunity to consider the best course of action, the Clayton QTIP plan provides considerably more time to do so.

- Powers of Appointment. The bypass trust created in conjunction with a Clayton QTIP plan may provide the surviving spouse with a limited power of appointment. A disclaimer to a bypass trust that provides the surviving spouse with a power of appointment will not satisfy the requirements under the Code, so a bypass trust created in a disclaimer plan cannot provide the spouse with such a power.[154]
- Technical Requirements. A qualified disclaimer must be made in conformity with several technical requirements in order to be valid. For example, a qualified disclaimer cannot be made with respect to an interest in property if the disclaimant has accepted the interest or any of its benefits, expressly or impliedly, prior to making the disclaimer.[155] If the surviving spouse has inadvertently accepted a benefit of the interest to be disclaimed, the opportunity to make the disclaimer will be lost. Making a Clayton QTIP election has technical requirements as well, but they are relatively easy to meet and are not nearly as likely to fail due to inadvertent acts on the part of the executor or surviving spouse.

D. Reverse QTIP Elections

Code section 2652(a)(3) authorizes the deceased spouse's executor to make an election to treat QTIP trust property as if the QTIP election had not been made for the purposes of the GST tax. The result of this election is that the deceased spouse, rather than the surviving spouse, will be treated as the transferor of the QTIP trust, thereby enabling the deceased spouse's executor to allocate the deceased spouse's GST tax exemption amount to the QTIP trust. This election is known as a "reverse QTIP."[156] Once it is made, a reverse QTIP election is irrevocable.[157]

A reverse QTIP election it not effective unless it is made with respect to all of the property in the trust to which the QTIP election applies.[158] Consequently, it is not possible to make a partial reverse QTIP election, but the executor can sever the QTIP trust into separate trusts and make the election with regard to one of those trusts. This process is often referred to as a "qualified severance" and must be undertaken in compliance with the terms and provisions of section 26.2654-1(b) of the Regulations.

A qualified severance may be made if the trust is severed pursuant to (i) a direction in the governing instrument providing that the trust is to be divided upon the death of the transferor or (ii) discretionary authority granted either under the governing instrument or local law.[159] Section 26.2654-1(b)(1)(ii)(B) of the Regulations provides that the severance must occur prior to the due date of the estate tax return, but that provision is subject to two major exceptions. First, if a local

[153] I.R.C. § 2518(b)(2).
[154] *See* I.R.C. § 2518(b)(4); Treas. Reg. §§ 25.2518-2(e)(2), 25.2518-2(e)(5), Example 5.
[155] Treas. Reg. § 25.2518-2(d)(1).
[156] Treas. Reg. § 26.2652-2(a).
[157] Treas. Reg. § 26.2652-2(a).
[158] *Id.*
[159] Treas. Reg. § 26.2654-1(b)(1).

court is required to authorize the severance but has not yet issued an order prior to the filing of the return, then the executor must indicate on a statement attached to the return that a proceeding has been commenced to sever the trust and describe the manner in which the trust is proposed to be severed.[160] Second, if the severance is authorized by the trust instrument or local law, a severance will be treated as meeting the requirements of the Regulations if the executor indicates on the return that separate trusts will be created (or funded) and clearly sets forth the manner in which the trust is to be severed and the separate trusts funded.[161]

E. Inter Vivos QTIP Elections

An inter vivos QTIP election must be made by the donor-spouse on a timely filed Form 709 United States Gift (and Generation-Skipping Transfer) Tax Return.[162] Gift tax returns are generally due on April 15th of the year after the gift was made, but an automatic six month extension of time to file will be granted upon request.[163] If the donor-spouse dies during the year in which he or she made the gift, the gift tax return must be filed on or before the earlier of (i) the due date of the estate tax return (with extensions) or (ii) the date on which the gift tax return would otherwise be due (with extensions).[164] Once made, an inter vivos QTIP election is irrevocable.[165]

As is the case with a Form 706 QTIP election, partial elections are also permitted for inter vivos QTIPs.[166] However, there are no gift tax Regulations that appear to authorize a Clayton QTIP election for gift tax purposes.

A reverse QTIP election may be made in conjunction with a gift made to an inter vivos QTIP.[167] However, allocating GST tax exemption to an inter vivos QTIP trust may not represent the best and highest use of that exemption. Before making the reverse QTIP election, the donor-spouse should consider the following factors:

- The Potential for Distributions to the Donee-Spouse: At a minimum, the donee-spouse will receive annual distributions of all of the income (or the specified unitrust amount, if applicable) from the inter vivos QTIP trust. The donee-spouse is obviously not a skip person, so each of those distributions will represent an inefficient use of GST tax exemption. If the spouse is also entitled to distributions of principal, this inefficiency is magnified. On the other hand, if the trust does not allow for distributions of principal for the donee-spouse, and if the donor-spouse expects the trust assets to appreciate significantly over time, the use of GST tax exemption may be worthwhile.
- The Remainder Beneficiaries: The identity of the remainder beneficiaries is also important. If the trust assets will pass to the donor-spouse's descendants upon the donee-spouse's death, the inter vivos QTIP may represent an excellent opportunity to allocate GST tax exemption. If instead the trust assets will pass to other family members, or a trust for the benefit of the donor-spouse, it could be years or even decades before the trust assets

[160] Treas. Reg. § 26.2654-1(b)(2).
[161] *Id*.
[162] I.R.C. § 2523(f)(4)(A).
[163] I.R.C. § 6075(b)(1), (2). Note that an extension of time to file the donor-spouse's income tax return also extends the gift tax return. Alternatively, the donor spouse may request an extension by filing a Form 8892.
[164] I.R.C. § 6075(b)(3).
[165] I.R.C. § 2523(f)(4)(B).
[166] Treas. Reg. § 25.2523(f)-1(b)(3)(i).
[167] I.R.C. § 2652(a)(3)(B).

pass to or for the benefit of a skip person. In that case, the settlor should consider whether it may be preferable to preserve the GST tax exemption for other applications.

- Other Planning Opportunities. The donor-spouse should consider what opportunities exist for allocating GST tax exemption either in conjunction with his or her foundational estate planning documents or future planning transactions. For instance, if the donor-spouse intends to engage in significant gifting for the benefit of descendants, it may be best to preserve the GST tax exemption for use in conjunction with those plans.

None of these factors should be considered determinative on their own, so it will be important for the donor-spouse and his or her advisors to examine them in conjunction with the donor-spouse's overall estate planning goals to determine the best course of action.

F. Making Late Elections and Fixing Mistakes

Sometimes things do not go as planned. Settlors fail to update old estate plans that are no longer appropriate, executors miss deadlines, the wrong election may be made, or perhaps no election is made at all. Fortunately, there are several avenues for potential relief when marital deduction planning goes awry.

1. 9100 Relief

9100 relief offers taxpayers the opportunity to request extensions of time to make certain statutory and regulatory elections. This relief is granted under sections 301.9100-1, 301.9100-2, and 301.9100-3 of the Regulations, hence the term "9100 relief."[168]

a) Automatic Extensions

Section 301.9100-2 of the Regulations addresses automatic extensions and has limited application with regard to the QTIP election. In relevant part, the Regulations provide that taxpayers are entitled to an automatic six-month extension for regulatory or statutory elections whose due dates are the due date of the return or the due date of the return including extensions.[169] The extension is only available if the taxpayer filed a timely return, and the extension runs six months from the due date of a return excluding extensions.[170]

For example, assume that W made a gift to a trust for the benefit of H in 2022. W files a gift tax return on April 10, 2024 but fails to make the inter vivos QTIP election. If she follows the requisite procedural requirements, W may file an amended gift tax return to make the inter vivos QTIP election by October 16, 2024, six months from the due date of the return.

As this example demonstrates, the automatic extension is only available to taxpayers who file in advance of the due date (whether with or without the extension). It essentially allows taxpayers to file an amended return to make an election at any time on or before the date that would have been the due date if they had initially requested an extension of time to file the relevant return. Generally speaking, an automatic extension will only be available to make an inter vivos QTIP election on or before October 15th of the year after the gift was made or to make an estate tax QTIP election on or before the date that is 15 months from the deceased spouse's date of death.

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[168] There is no need to go looking for Code section 9100, as it does not exist.
[169] Treas. Reg. § 301.9100-2(b).
[170] *Id*.

b) Other Extensions

Any other requests for extensions of time that do not meet the requirements under section 301.9100-2 may be made if they meet the requirements under section 301.9100-3. Note that extensions under this section are available for regulatory elections but not for statutory elections. As the nomenclature suggests, a statutory election is an election whose due date is prescribed by statute, while a regulatory election is an election whose due date is prescribed by the Regulations.[171]

Code section 2056(b)(7)(B)(v) provides that the QTIP election must be made on the estate tax return, but it makes no mention of a due date. That task was left to the drafters of the Regulations,[172] so the estate tax QTIP election is a regulatory election that is eligible for 9100 relief.

Unfortunately, the opposite situation exists with regard to the inter vivos QTIP election. Code section 2523(f)(4)(A) specifies that the inter vivos QTIP election must be made on a gift tax return filed on or before the due date (with extensions). Because the due date for the inter vivos QTIP election is prescribed by statute and not the Regulations, relief under section 301.9100-3 is not available to make a late inter vivos QTIP election. Many commentators find that this arbitrary distinction imposes an undue hardship on taxpayers, and both the American Institute of CPAs and the American College of Trust and Estate Counsel have publicly supported legislation to allow 9100 relief for failure to make an inter vivos QTIP election. For now, practitioners must take extra care to ensure that inter vivos QTIP elections are made properly and on a timely filed gift tax return.

A request for relief under section 301.9100-3 must establish that the taxpayer acted reasonably and in good faith, and that a grant of an extension will not prejudice the interests of the Government.[173] A taxpayer will be deemed to have acted reasonably and in good faith if the taxpayer:

- Requests relief before the failure to make the election is discovered by the Service;
- Failed to make the election because of intervening events beyond the taxpayer's control;
- Failed to make the election because, after exercising reasonable diligence (taking into account the taxpayer's experience and the complexity of the return or issue), the taxpayer was unaware of the necessity for the election;
- Reasonably relied on the written advice of the Service; or
- Reasonably relied on a qualified tax professional who failed to make or advise the taxpayer to make the election.[174]

A taxpayer is deemed not to have acted reasonably and in good faith if the taxpayer:

- Seeks to avoid an accuracy related penalty that has been or could be imposed under Code section 6662;
- Was well-informed regarding the nature and tax consequences of the election and simply chose not to make it; or

[171] Treas. Reg. § 301.9100-1(b).
[172] *See* Treas. Reg. § 20.2056(b)-7(b)(4)(i).
[173] Treas. Reg. § 301.9100-3(a).
[174] Treas. Reg. § 301.9100-3(b)(1).

- Uses hindsight in requesting relief (i.e. if specific facts have changed since the due date of the return that now make the election advantageous to the taxpayer).[175]

To request relief under section 301.9100-3, the taxpayer will be required to file a letter ruling request under Rev. Proc. 2023-1 (or the relevant Revenue Procedure for the year in question).[176] In the case of a letter ruling request seeking an extension of time to file a QTIP election, the executor and any other parties having knowledge of the events that led to the failure to make the QTIP election and the discovery of that failure must submit detailed affidavits, under penalty of perjury, describing those events.[177] The "other parties" who may be involved include the preparer of the estate tax return, any individual who made a substantial contribution to the preparation of that return, and any accountant or attorney who is knowledgeable in tax matters who advised the executor regarding the QTIP election.[178] Assuming that the executor relied on a tax professional for advice regarding the estate tax return, the executor's affidavit must describe the engagement and responsibilities of that professional and the extent to which the executor relied on that professional.[179] Finally, the request must also include certain information about the estate tax return, such as whether it is under audit, when it was due and when it was actually filed, and copies of any documents that refer to the QTIP election.[180]

2. Late Reverse QTIP Elections

In certain circumstances, an executor or trustee may be able to request relief to make a late reverse QTIP election without filing a request for a letter ruling. Relief is available under Rev. Proc. 2004-47 if:

- A valid QTIP election was made for the marital trust on the estate tax return;
- The reverse QTIP election was not made on the estate tax return because the executor relied on the advice of counsel or a qualified tax professional who failed to advise the executor of the need, advisability, or proper method to make a reverse QTIP election;
- The decedent has a sufficient amount of unused GST tax exemption, after the application of the automatic allocation rules, to result in a zero-inclusion ratio for the reverse QTIP trust;
- The estate is not eligible for the automatic six-month extension under section 301.9100-2(b) of the Regulations;
- The surviving spouse has not made a lifetime disposition of all or any part of the QTIP trust; and
- The surviving spouse is alive or no more than six months have passed since the date of the surviving spouse's death.

If the above criteria are met, the taxpayer must follow the procedural requirements as set forth in Section 4.03 of the Revenue Procedure to request relief. If relief is granted, the decedent will be treated as the transferor for GST tax purposes and his or her remaining GST tax exemption amount

[175] Treas. Reg. § 301.9100-3(b)(3).
[176] Treas. Reg. § 301.9100-3(e)(5).
[177] Treas. Reg. § 301.9100-3(e)(2), (3).
[178] Treas. Reg. § 301.9100-3(e)(3).
[179] Treas. Reg. § 301.9100-3(e)(2).
[180] Treas. Reg. § 301.9100-3(e)(4).

will be automatically allocated to the QTIP trust based on the value of trust property as finally determined for estate tax purposes.[181]

As discussed previously, partial reverse QTIP elections are not permitted, so the decedent must have a sufficient amount of GST tax exemption remaining to cover the entire value of the QTIP trust, as a late qualified severance of the marital trust cannot be authorized under Revenue Procedure 2004-47. In that event, the executor will have to request 9100 relief to make a late reverse QTIP election in conjunction with a late qualified severance.[182]

3. Unnecessary Elections

Revenue Procedure 2016-49 provides that certain QTIP elections will be treated as void if the following requirements are satisfied:

- The estate's federal tax liability is zero, regardless of the QTIP election, based on values as finally determined for federal estate tax purposes, thus making the QTIP election unnecessary to reduce the federal tax liability; and
- The executor of the estate neither made nor was considered to have made the portability election.

Note that the Revenue Procedure will not treat a QTIP election as being void in cases involving protective elections, formula elections designed to reduce the estate tax to zero, a portability election (even if the decedent's DSUE amount was zero), or when a partial QTIP election was required to reduce the estate tax liability and the executor made the election with regard to more property than was necessary to reduce that liability to zero.[183]

If relief is granted pursuant to this Revenue Procedure, the relevant trust will no longer be subject to the following sections of the Code:

- 2044(a), meaning that the interest will no longer be includible in the surviving spouse's gross estate as qualified terminable interest property;[184]
- 2056(b)(7), meaning that the trust will no longer be subject to the QTIP provisions to the extent that they are not otherwise required by the trust instrument;
- 2519(a), meaning that the surviving spouse's disposition of part or all of the income interest with respect to the property will not be subject to gift tax under this section.
- 2652, meaning that the surviving spouse will not be treated as the transferor for GST tax purposes.[185]

Note that the Revenue Procedure provides that the Service will no longer accept requests for letter rulings for relief relating to unnecessary QTIP elections. Instead, taxpayers must follow the procedural requirements as set forth in Section 4.02 therein.

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[181] Rev. Proc. 2004-47, 2004-2 C.B. 169. Note that relief will only result in the allocation of GST tax exemption to the QTIP trust. It will not extend the time to make an allocation of any remaining GST tax exemption.
[182] *Id*.
[183] Rev. Proc. 2016-49, 2016-42 I.R.B. 462.
[184] Provided, of course, that the interest may be subject to estate inclusion under another section of the Code if applicable.
[185] Rev. Proc. 2016-49, 2016-42 I.R.B. 462.

4. Using Disclaimers

Disclaimer planning can sometimes be used to effectively modify the terms of a trust so that it will qualify for the marital deduction. For example, assume that the deceased spouse's will includes a bequest to a trust that provides all of the income to the surviving spouse for life and authorizes the trustee to make discretionary distributions of principal to the deceased spouse's children. If the children all make qualified disclaimers of their rights to receive principal distributions, the executor will be able to make a valid QTIP election over the trust.[186]

Alternatively, a disclaimer may be able to convert an interest that qualifies for the marital deduction under Code section 2056(b)(5) into an interest that qualifies under Code section 2056(b)(7). A general power of appointment trust will be able to qualify as a QTIP trust if (i) the surviving spouse disclaims his or her general power of appointment and (ii) the deceased spouse's executor makes the QTIP election.

A disclaimer made for federal tax purposes must be made in accordance with Code section 2518 and the associated Regulations as well as applicable state law. Texas disclaimers are subject to the Texas Uniform Disclaimer of Property Interests Act, which can be found in Chapter 240 of the Texas Trust Code.[187]

VI. TAXATION OF THE MARITAL TRUST

As was noted earlier in this article, any interest that qualifies for the marital deduction will be includible in the recipient spouse's gross estate. As a result, the disposition of that interest by the recipient spouse will be subject to either gift or estate tax, depending on whether the disposition occurs during life or at death. This section of the article will provide an overview of the taxation of marital trusts in these two situations.

A. Disposition of a QTIP Interest During Life

Code section 2519 provides that if a spouse disposes of all or any part of his or her qualifying income interest in a marital trust, that disposition will be treated as a transfer of the entire trust (except for the income interest) for gift tax purposes. This section is equally applicable to inter vivos and testamentary QTIP trusts.[188]

The application of section 2519 will be triggered whether the disposition of the qualifying income interest is a gift or a sale.[189] If spouse gifts his or her income interest, that gift will be subject to gift tax under Code section 2511 and may be eligible for the gift tax annual exclusion.[190]

The value of the gift under section 2519 will be equal to the fair market value of the entire property subject to the qualifying income interest, determined as of the date of the disposition and including any accumulated income, less the value of the qualifying income interest as of the date

[186] Treas. Reg. § 20.2056(b)-7(h), Example 4; I.R.S. Priv. Ltr. Rul. 199949023 (Dec. 10, 1999).
[187] For a detailed look at this statute, *see* Glenn M. Karisch, Thomas M. Featherston, Jr., and Julia E. Jonas, *Disclaimers Under the New Texas Uniform Disclaimer of Property Interests Act*, State Bar of Texas Estate Planning and Probate Drafting Course, Houston, Texas, October 8-9, 2015.
[188] I.R.C. § 2519(b).
[189] *See* Treas. Reg. § 25.2519-1(g), Examples 1 and 2.
[190] Treas. Reg. § 25.2519-1(c)(1).

of disposition.[191] The gift tax annual exclusion amount will not apply to the gift.[192] If the spouse has enough exclusion amount to cover the value of the gift, that is the end of the story. If gift tax will be due, further calculations may be required.

Code section 2207A(b) provides that the spouse is entitled to recover the amount of gift taxes imposed pursuant to section 2519 from the person receiving the property. The amount of the gift under section 2519 will be reduced by the amount of gift tax the spouse is entitled to recover under section 2207A(b), as determined based on an interrelated computation.[193] Note that if the spouse dies within three years of a gift pursuant to Code section 2519, then the gift tax paid by the transferees may be includible in the spouse's gross estate.[194]

The spouse's failure to exercise his or her right to recovery under section 2207A(b) will be treated as a gift of the amount of the recoverable tax, even if recovery of the tax is impossible.[195] Any delay in the spouse's exercise of his or her rights of recovery will be treated as a below market loan subject to gift tax.[196] The spouse may also waive his or her right to recovery before that right becomes unenforceable.[197] If the spouse executes a waiver, a gift of the unrecovered amounts will be considered to be made as of the later of the date of the waiver or the date on which the gift tax was paid.[198]

B. Upon the Surviving Spouse's Death

Each type of marital trust will be included in the surviving spouse's gross estate upon his or her death. A general power of appointment trust is includible pursuant to Code section 2041, while an estate trust is includible pursuant to section 2033. QTIP trusts are includible pursuant to Code section 2044.

1. Inclusion Under Code Section 2044

Code section 2044 applies to any interest in which the surviving spouse had a qualifying income interest for life and for which a deduction was allowed under Code section 2056(b)(7) or 2523(f).[199] If an interest meets both requirements, it will be presumed that the full value of the trust is includible in the surviving spouse's estate.[200] The burden will be on the surviving spouse's executor to prove otherwise, such as by producing a copy of the deceased spouse's estate or gift tax return showing that only a partial election (or no election at all) was made.[201]

The amount included under Code section 2044 is the value of the entire interest in which the surviving spouse had a qualifying income interest for life, determined as of the surviving spouse's date of death.[202] If only a partial QTIP election was made in connection with the interest, the

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[191] Treas. Reg. § 25.2519-1(c)(1).
[192] *Id*.
[193] Treas. Reg. § 25.2519-1(c)(4).
[194] *See*, *e.g.*, *Estate of Morgens v. Comm'r*, 678 F3d 769 (9th Cir. 2012).
[195] Treas. Reg. § 25.2207A-1(b)(1).
[196] *Id*.
[197] Treas. Reg. § 25.2207A-1(b)(2).
[198] *Id*.
[199] I.R.C. § 2044; Treas. Reg. § 20.2044-1(a).
[200] Treas. Reg. § 20.2044-1(c).
[201] *Id*.
[202] Treas. Reg. § 20.2044-1(d)(1). Note that if alternate valuation is elected, the interest will be valued as of the alternate valuation date.

amount includible in the surviving spouse's estate will be equal to the fair market value of the entire interest as of the date of his or her death, multiplied by the fractional or percentage share for which the deduction was taken.[203] If the elective and nonelective shares were not segregated in conjunction with a partial election, note that the applicable fraction or percentage will need to be recalculated if distributions of principal are made from the elective share.[204]

Any property that is included in the surviving spouse's gross estate under Code section 2044 is treated as having passed from the surviving spouse for purposes of the estate tax and the GST tax (unless the interest was previously the subject of a reverse QTIP election by the deceased spouse).[205] As a result, the property may be subject to the charitable deduction, marital deduction (if the surviving spouse has remarried), special use valuation under Code section 2032A, and the installment payment of estate tax under Code section 6166, as applicable.[206] Perhaps most notably, the property will be considered to have passed from the surviving spouse for purposes of Code section 1014, meaning that the entire interest will receive a basis adjustment as of the surviving spouse's date of death.[207]

2. Recovery of Estate Tax

Code section 2207A(a) provides that the surviving spouse's estate shall be entitled to recover the estate tax attributable to the inclusion of a QTIP trust from the trust or from the persons who have received a distribution of trust property prior to the expiration of the right to recovery.[208] The amount of estate tax attributable to the QTIP trust is equal to the amount by which the total amount of estate tax paid exceeds the amount of tax that would have been paid if the QTIP trust had not been includible.[209] Interest and penalties attributable to the tax are also recoverable.[210]

The surviving spouse may waive the right to recovery in his or her will or revocable trust by specifically indicating that intention.[211] A waiver may be accomplished by making specific reference to the QTIP trust, Code section 2044, or Code section 2207A, but a general provision specifying that all taxes will be paid by the estate is insufficient to waive the right to recovery.[212]

If the surviving spouse does not waive the right to recovery, then the executor will generally have a duty to enforce its rights to recover the tax. The executor's failure to exercise a right of recovery results in a taxable gift equal to the unrecovered amount from the persons who would benefit from the recovery to the persons from whom the recovery could have been obtained.[213] In other words, the surviving spouse's residuary beneficiaries will have made a gift to the QTIP trust's remainder beneficiaries.

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[203] *Id*.
[204] *See* Treas. Reg. §§ 20.2044-1(d)(3), 20.2044-1(e), Example 4.
[205] I.R.C. § 2044(c).
[206] Treas. Reg. § 20.2044-1(b).
[207] *Id*.
[208] Treas. Reg. §§ 20.2207A-1(a)(1), 20.2207A-1(d).
[209] I.R.C. § 2207A(a)(1); Treas. Reg. § 20.2207A-1(b).
[210] *Id*.
[211] I.R.C. § 2207A(a)(2).
[212] I.R.C. Priv. Ltr. Rul. 200452010 (Dec. 24, 2004).
[213] Treas. Reg. § 20.2207A-1(a)(2).

VII. CONCLUSION

While many aspects of gift and estate taxation continue to shift and evolve, the foundational principles of marital deduction planning have remained relatively unchanged for decades. Estate planners must constantly monitor and study changes in the tax laws and new guidance from the Service while also meeting the needs of their clients, so it can be tempting to rely on past knowledge and experience when it comes to more familiar concepts like the marital deduction. However, by periodically revisiting the fundamentals of marital deduction planning and its numerous and versatile applications, practitioners will be better prepared to offer innovative and effective solutions for their clients.