

# **REVOCABLE CREDIT SHELTER TRUST WITH QUALIFIED DOMESTIC TRUST PROVISION (QDOT)**

**(For benefit of Grantor's noncitizen spouse and remainder to children.)**

## **HIGHLIGHTS OF THE PLAN**

### **ESTATE AND GIFT TAX MARITAL DEDUCTION**

One of the most important and versatile planning tools available to estate planners is the unlimited marital deduction. The marital deduction permits the assets of a married couple to be free of estate and gift tax until the death of the survivor. At that time all assets owned by the survivor, including those received from the first spouse to die, will be included in the survivor's estate for estate tax purposes.

In larger estates, the first spouse to die often leaves an amount equal to the estate tax exemption \* in trust for the benefit of family members other than the spouse to ensure that the estate tax exemption is not wasted. The surviving spouse is generally given an income interest payable at least annually in all income produced by the trust. The executor may then elect to treat all amounts in excess of the estate tax exemption amount as qualified terminable interest property (QTIP). The QTIP election permits all property subject to election to qualify for the estate tax marital deduction provided that such property is included in the estate of the surviving spouse at that spouse's death.

For example, assume that H & W have an estate worth \$3,000,000, of which W owns \$300,000 and H owns the remaining \$2,700,000. H dies and leaves everything to a family trust that pays all income at least annually to W, with the remainder at W's death to H & W's two children. Since W's interest in the trust is terminable at her death, the property in the trust would not qualify for the estate tax marital deduction and would be included in H's estate and be subject to estate taxes. However, if the executor elects to treat all trust property in excess of the estate tax exemption amount (the amount sheltered by the unified estate tax credit) as qualified terminable interest property (QTIP), no estate tax would be payable at H's death because the QTIP would qualify for the estate tax marital deduction. As such, it would not be subject to estate taxes until W's death.

### **QUALIFIED DOMESTIC TRUST**

Certain planning problems arise when the surviving spouse is not a citizen of the United States. In the absence of a Qualified Domestic Trust (QDOT), the marital deduction is not available to the surviving noncitizen spouse. In other words, if the noncitizen spouse outlives the citizen spouse, the QDOT provision will make the marital deduction available at the citizen spouse's death so that all estate taxes are postponed until the noncitizen spouse's death. (IRC Sec. 2056(d))

QDOT property must otherwise qualify for marital deduction treatment under a QTIP trust, general power of appointment trust, estate trust (income payable to spouse during life with principal and remaining income payable to spouse's estate), or special rule charitable remainder trust (income to spouse with remainder to charity). In order for the QDOT to qualify for the marital deduction, it must also meet the following additional requirements:

1. At least one of the trustees must be a U.S. citizen or domestic corporation, and if the QDOT has more than \$2,000,000 in assets, one of the trustees must be a U.S. bank or the U.S. trustee must provide a bond equal to at least 65% of the value of the QDOT property.
2. No distribution (other than income or for certain hardship situations) may be made from the trust unless the domestic trustee has the power to withhold any gift or estate taxes due on such distribution. (IRC Sec. 2056A)

Gift taxes are due on any distributions of principal during the noncitizen spouse's lifetime. Estate taxes are due at the death of the noncitizen spouse, computed as if such property had been included in the citizen spouse's estate at his or her death. (Temp. Reg. Sec. 20.2056A-T(d)(1)(i))

The revocable trust with QDOT provision should be used in tandem with a pour-over trust that will place all assets owned by the citizen spouse that are outside the revocable trust into the trust at his or her death.

\* For a schedule of the estate and gift tax provisions, please see the document entitled Federal Estate and Gift Tax Rates and Credits located under Special Files.