Trust & Estates
Taxes and Planning

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Reverse QTIP election
§2652(a)(3)

In general, to qualify for the marital deduction, the interest in property passing to the surviving spouse cannot end at some point in time or by the occurrence of some event. One example of a terminal interest which does qualify, is an interest which is conditional upon the spouse surviving up to a period of six months following the death of the decedent. Another is qualified terminal interest property (QTIP).

A QTIP interest gives the surviving spouse a life estate in the income without granting him or her a general power of appointment. QTIPs are useful where the surviving spouse is not capable of managing assets independently or the testator has concerns about his children not getting a fair share of their inheritance due to a remarriage on the part of the surviving spouse. Also important is the ability to defer taxes until the death of the second spouse.

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Section 691(c)
IRD estate tax deduction

Income in respect of a decedent arises due to the fact that an estate includes amounts that the decedent was entitled to, but had yet not received as of the date of death. Simply put the value of the assets in a decedent's estate are calculated on an accrual basis while the tax year ending with the death of the decedent, for income tax purposes, is generally computed on a cash basis. (A common exception is medical expenses of the decedent paid within twelve months after death. These costs can be deducted on the decedent's final 1040 despite not having been paid before the date of death).

Typical examples of IRD include payments of pension plan survivor benefits, IRA distributions, payments of interest or dividends accrued at date of death and the accounts receivable of a cash basis sole proprietor.

As an item of IRD, an IRA distribution, for example, is taxed upon receipt by the estate or trust on its 1041 or by the beneficiary on his or her 1040. There is a double taxation as the full date of death value of the IRA was included and potentially taxed on the estate form 706.

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To qualify the surviving spouse must be entitled to all the income of the trust for life, it must be paid at least annually and no one can have the power to appoint the property to someone other than the surviving spouse. Additionally an irrevocable election must be made and the property must be included in the surviving spouse's estate.

One disadvantage of the QTIP is that for GSTT purposes the property is considered to be transferred by the surviving spouse so that if the remainder beneficiaries are grandchildren, the decedent cannot use any of his GSTT exemption on the QTIP property. This may result in some unused GSTT exemption which like the estate tax exemption, now stands at $5,000,000.

Fortunately §2652(a)(3) allows the assets to be treated, **only for GSTT purposes**, as if the first spouse were the transferor. In other words the so-called "reverse QTIP election" treats the assets as if the QTIP election had never been made.

The example on page 3 serves to illustrate the tax benefits of the reverse election.

The election to allocate a portion of the decedent's available GST exemption to QTIP property is made on the estate return on which the QTIP election is made. In order to make the election, the qualifying property is listed on line 9 of Part 1 on Schedule R. The election, once made, is irrevocable.

§691 (continued from page 1)

Therefore to compensate, a trust, estate or individual collecting IRD, can take an income tax deduction for the amount of estate tax attributable to that item of IRD.

IRD collected is reported based on the type of income, i.e interest on line 1 of the 1041, dividends on line 2 etc. Deductions in respect of a decedent (DRD) are reported on line 15a. After computing the estate deduction for the net IRD the deduction is reported for trusts & estates on line 19 of form 1041. If received by an individual it is taken on form 1040, Schedule A, as a miscellaneous itemized deduction not subject to the two-percent of AGI limitation. It is reported to the individual by the estate on line 10, Schedule K-1 of its form 1041.

The deduction for estate taxes paid is computed by determining the federal estate tax on the estate, then determining the estate tax again without including the items of net IRD. The difference between the two calculations is the deduction available for estate taxes.

Example:

Estate value includes $75,000 IRA and 25,000 accrued bond interest (both IRD) as well as 15,000 accounts payable from a business(DRD). The total estate tax was 60,000.
If upon recomputing the tax without the net IRD of 85,000 (75,000 + 25,000 – 15,000), the tax due is 32,000, then the total 691(c) deduction is therefore 28,000 (60,000 - 32,000).

If in 2010 15,000 of interest is collected, 20,000 of the IRA is received and 8,000 of the A/P is paid, the **estate tax deduction for the current year is:**

$$\frac{\$27{,}000}{85{,}000} \times 28{,}000 = \mathbf{\$8{,}894}$$

(Current year net IRD / total net IRD) x total estate tax deduction.)

Decedent's Estate :	$10,000,000	Terms of trusts – Income to spouse for life	
Lifetime gifts to children:	1,200,000	Remainder to grandchildren	
Estate tax exemption remaining:	3,800,000		
GST tax exemption remaining:	5,000,000	(S) Surviving spouse	(D) Decedent

Assets transferred to	Amount	Tax	Subject to tax (millions)	Explanation
Example 1				
Credit-shelter trust	3,800,000	Estate (D)	0	3.8 million of estate tax exemption used
		GST (D)	0	3.8 million of GST tax exemption used
QTIP Trust	6,200,000	Estate (D)	0	Marital Deduction
		GST (D)	0	Spouse is transferor to skip persons
		Estate (S)	1.2	6.2 less 5.0 estate tax exemption
		GST (S)	1.2	6.2 less 5.0 GST tax exemption
		Total subject to tax	2.4	
		Tax @35% =	$840,000	
Example 2				
Credit-shelter trust	3,800,000	Estate (D)	0	3.8 million of estate tax exemption used
		GST (D)	0	3.8 million of GST tax exemption used
QTIP Trust	1,200,000	Estate (D)	0	Marital Deduction
(Reverse QTIP election)		GST (D)	0	1.2 remaining GST tax exemption used (due to Reverse QTIP election)
		Estate (S)	0	1.2 million of estate tax exemption used
		GST (S)	0	Decedent is deemed transferor for GST
QTIP Trust	5,000,000	Estate (D)	0	Marital deduction
		GST (D)	0	Spouse is transferor to skip persons
		Estate (S)	1.2	3.8 remaining estate tax exemption used
		GST (S)	0	5.0 million GST tax exemption used
		Total subject to tax	1.2	
		Tax @35% =	$420,000	

Difference of $420,000 is due to decedent utilizing full GST tax exemption leaving the maximum $5,000,000 exemption available for spouse.

Reverse QTIP election

Trusts & Estates

Taxes and Planning

Federal Tax Information

	2011	2010
Standard Deduction (MFJ)	11,600	11,400
Standard Deduction (Single)	5,800	5,700
Personal Exemption	3,700	3,650
Child Tax Credit	1,000	1,000
Child Care Credit	3,000	3,000
Earned Income Credit	3,050	3,050
FICA maximum earnings	106,800	106,800
Auto mileage allowance	.51	.50
Defined Contribution limit	49,000	49,000
401(k) & 403(b) limit	16,500	16,500
401(k) & 403(b) age 50+	22,000	22,000

IRS	General Information	800-829-1040
	EINs	800-829-4933
	Form 706 & 709	866-699-4083
NJ	General Information	609-826-4400
	Estate & Inheritance	609-292-5033
NY	General Information	518-457-5181
	Estate Tax	518-457-5387
CT	General Information	860-297-5962
PA	General Information	717-787-8201

Important Phone Numbers

	2011	2010
IRA or Roth	5,000	5,000
IRA or Roth age 50+	6,000	6,000
AMT exemption (MFJ)	74,450	72,450
AMT exemption (Single)	48,450	47,450
§179 Expensing	500,000	500,000

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