

Basic Estate Planning for Second Marriages

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The Problem. Very often, people need advice for estate planning for their “blended family”. This means they have a spouse and children from a previous marriage. The previous marriage may have ended due to death or divorce. Also, the children may have been born out of wedlock and marriage to the biological parent never took place for a myriad of reasons. Is there a way to set up a plan so that if the current spouse survives, the spouse is provided for, and when the spouse dies later, the children from the previous marriage/relationship are given some share of the estate? Establishing a Qualified Terminable Interest Property Trust (QTIP) can help meet these goals.

The solution. A QTIP Trust can specify that the surviving spouse receives income from the trust assets and some principal distributions. However, under IRS guidelines, the surviving spouse must *not* be permitted by the Trust to receive *unrestricted* access to principal or be able to decide where trust assets are distributed upon his/her subsequent death.

Upon the death of the surviving spouse, the remaining trust assets would be distributed to the beneficiaries you designate, such as the children from the previous marriage/relationship, for example. Grandchildren or charities can also be included among the final beneficiaries.

Key decision: Trustee. In the QTIP trust document, you must specify who is to become the successor Trustee of the Trust upon your death. In “blended family” situations, it may not be wise to name the surviving spouse as the successor Trustee. It is often not wise to name a child from the previous marriage/ relationship as the successor Trustee either. Sometimes, the best candidate for a successor Trustee will be a bank or trust company or other trusted professional advisor. The surviving spouse will want to maximize the income generated by the trust assets while the children from the previous marriage/relationship will want to preserve principal. Objective, professional advice and decision making will be extremely important if you are setting up a QTIP Trust in a blended family situation.

Critical drafting details. Under IRS rules, the assets in your QTIP Trust will not be subject to estate tax when the surviving spouse dies if the QTIP Trust is drafted correctly. Assets you give unrestricted to your surviving spouse qualify for the “unlimited marital deduction” when computing the federal estate tax. Therefore, if one leaves all of his/her assets outright to a surviving spouse, there is no estate tax owed since all of the assets qualify for the unlimited marital deduction. But, with a blended family, for the reasons stated above, it is undesirable to leave assets completely unrestricted to their surviving spouse.

A problem occurs when a trust gives a spouse an interest in property that can terminate. Such a gift will not qualify for the marital deduction. For example, a husband leaves his wife an “income only” interest in a trust and the trust further specifies that when wife dies, the trust assets go to husband’s brother. Wife has no power to change the use of the trust assets. She thus has a “terminable interest” that does not qualify for the marital deduction.

Another example would be a wife #1 leaving her real estate to her husband so long as he remains unmarried after her death. If he remarries, the real estate will pass to wife #1’s nephew. Husband has a “terminable interest” in the real estate and it will not qualify for the marital deduction in wife #1’s estate.

The IRS does, however, allow certain terminable interests to qualify for the marital deduction if:

1. The surviving spouse has a lifetime right to all of the income of the Trust;
2. No other person can have the power during the surviving spouse’s lifetime to appoint any part of the property to any person other than the surviving spouse;
3. The surviving spouse is the sole lifetime beneficiary; and
4. The Executor of the deceased spouse’s estate makes an election to treat all or a specific portion of the trust property as Qualified Terminable Interest Property.

The surviving spouse may also be entitled to principal distributions from the QTIP trust. If the principal distributions must be limited to whatever the spouse needs for his/her “health, support, maintenance or education” so that the optimal estate tax objectives are met.

Conclusion. The twin goals of providing for a spouse and children from the previous marriage can be met with careful planning. Seek the advice of knowledgeable estate planning counsel if a “blended family” situation applies in your case.

The information in this article is not, nor is it intended to be legal advice. Please consult an attorney or other tax advisor for advice regarding your individual situation.

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