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Steve Leimberg's Estate Planning Email Newsletter - Archive Message #2932

Date: **12-Jan-22**

From: **Steve Leimberg's Estate Planning Newsletter**

Subject: **James M. Kane on Two Key 2022 Advantages for Inter-vivos QTIP Trusts vs. SLATs**

"An Inter-vivos QTIP trust can help avoid two problems that potentially exist for a SLAT vs. the Inter-vivos QTIP trust: (i) an asset protection and (ii) Section 2036 problems. In particular, here is the kicker on my Section 2036 point. If in the SLAT situation there is evidence of a preexisting agreement that a limited power of appointment will be used for the benefit of the settlor-spouse, such as in emails, memos, letters, notes, cash-flow projections, etc., than I believe that evidence greatly augments a creditor's assertion that the SLAT is a "self-settled" trust; with the result that a creditor today *could obtain a garnishment judgment and then sit and wait (even for years) before any distributions are made to the settlor-spouse. This creditor-reach could trigger also a surprising, and painful, loss of asset protection and a related Section 2036 trap."*

James M. Kane provides members with commentary that focuses on using an *Inter-vivos* QTIP trust for gift planning rather than a SLAT in view of a possible Congressional reduction in the estate/gift exemption.

Attorney James M. Kane, with the Atlanta law firm **KaneTreadwell Law** LLC [www.ktlawllc.com), is primarily a tax and trust planning attorney. Kane, for approximately the past 15 years, handled an extensive amount of trust and estate litigation (and planning); but beginning now in 2022 will handle these litigation matters principally only as a consulting and expert witness for both tax and non-tax litigation matters where trusts are at the center of the dispute. Prior to law school James was a Revenue Agent with the IRS's large-case examination division in Atlanta. This combined tax, trust, and litigation experience gives James a broad perspective for identifying, understanding, and addressing complex trust issues and disputes along with the resulting tax and non-tax factors that ideally must together be taken into account. James is licensed in Georgia, North Carolina, and New York. He has 25+ years' experience previously with Atlanta law firms Sutherland, Asbill & Brennan and Chamberlain, Hrdlicka, White, Williams & Aughtry. James attended Emory University Law School

and has undergraduate finance (University of Georgia) and graduate business (Georgia State University) degrees. Although he never worked as a CPA, James held a CPA certificate during his time with the IRS. James was the winner of the 2016 Heckerling Tax Court Brief writing contest. James' outside interests include studying jazz guitar, reading, and weightlifting. Google also: James Kane Legal Blog

Here is his commentary:

EXECUTIVE SUMMARY:

An *Inter-vivos* QTIP trust can help avoid two problems that potentially exist for a SLAT vs. the *Inter-vivos* QTIP trust; both (i) an asset protection and (ii) Section 2036 problem. In particular, here is the kicker on my Section 2036 point. If in the SLAT situation there is evidence of a preexisting agreement that a limited power of appointment will be used for the benefit of the settlor-spouse, such as in emails, memos, letters, notes, cash-flow projections, etc., than I believe that evidence greatly augments a creditor's assertion that the SLAT is a "self-settled" trust; with the result that a creditor *today* could obtain a garnishment judgment and then sit and wait (even for years) before any distributions are made to the settlor-spouse. This creditor-reach could trigger also a surprising, and painful, loss of asset protection and a related Section 2036 trap.

COMMENT:

I have been a fan of the *Inter-vivos* QTIP trust for many years. I now believe as we enter the continuing legislative uncertainty during 2022 that the QTIP is an almost-perfect gifting option (compared to other available options). Click **here** in my blog post Search tab for several of my previous posts about my praise for *Inter-vivos* QTIP trusts.

By contrast, there is going around now in this era of Congressional uncertainty a great deal of information about using a SLAT (spousal limited access trust). I do not get into the design or operational details of either the *Inter-vivos* QTIP or SLAT for purposes of this newsletter, other than as to my two points below. There is an abundance of good, explanatory information readily available on the web for both QTIPs and SLATs.

Point One. *Asset Protection in the Event the Beneficiary-Spouse Dies Prior to the Settlor-spouse*.

The essence of this first point is that I believe a secondary QTIP interest for the benefit of the settlor-spouse in an *Inter-vivos* QTIP trust is potentially much stronger and effective for asset protection purposes rather than a SLAT limited power of appointment in favor of the settlor-spouse.

My underpinning in making this point is that most married couples use a SLAT rather than simply an irrevocable gifting trust because the married couple -- after the SLAT trust funding -- likely still needs access to trust income and corpus from the SLAT for living expenses, etc. Or, at least a need by the settlor-spouse (who creates and funds the trust) for trust distributions from the SLAT if the beneficiary-spouse predeceases the settlor-spouse. Otherwise, the couple could simply fund an irrevocable gifting trust that benefits only their children and other descendants, with no access thereafter by either spouse to the trust.

And, in many cases, because of this need for likely access to the SLAT trust, the SLAT will often include written provisions that give a third-party a limited power of appointment so as to exercise, if ever necessary, the power in favor of the settlor-spouse in the event of an unanticipated early death of the beneficiary-spouse. Otherwise, upon an early death of the beneficiary-spouse, the settlor-spouse – absent this limited power of appointment -- has no access to the trust for his or her continuing support, etc.

Specifically, it is the long-running common law "relation back" doctrine for a power of appointment that concerns me with a SLAT. Meaning essentially that if the third-party exercises his or her limited power of appointment in favor of the settlor-spouse, this *relation back* doctrine treats the settlor-spouse as having exercised that power in his or her own favor. Keep in mind this relation-back points back to the settlor-spouse who created the limited power of appointment. Arguably this is substantively in the nature of a *quasi*-retained, beneficial interest in the settlor-spouse's own trust.

This means any distribution to the settlor-spouse by exercise of the limited power of appointment is treated as a "self-settled" distribution back to the settlor-spouse; thus, subject to claims by a creditor of the settlor-beneficiary-spouse. The creditor, however, cannot under long-running law

force the powerholder to exercise the limited power of appointment in favor of the settlor-spouse. But I believe a creditor can obtain a charging order *presently* that will later apply to the extent the limited power of appointment is exercised and a distribution *later* is made to the settlor-spouse. Or, let me put it this way; if I were a creditor I would try my best to obtain *presently* this kind of court order. More on this point below.

By contrast, Georgia is one of the handful of states that provide express asset protection against a "secondary QTIP interest" in a QTIP trust. This is where the settlor-spouse includes a provision in the QTIP trust giving her a QTIP beneficiary interest, conditioned on the event the beneficiary-spouse dies first. The statutory protection is under Georgia law at O.C.G.A. Section 53-12-82. Click **here** for my earlier Leimberg newsletter discussion about this Georgia statute.[1]

Although I am not aware of this Georgia Section 53-12-82 having yet been tested in the Georgia courts, the question in my view that remains unanswered is whether a creditor can garnish or levy on the distribution at the time any such secondary QTIP distributions occur. My gut reaction is "no"; otherwise, Section 53-12-82 would effectively have no more teeth than the use of a limited power of appointment in the above SLAT. But we simply do not know how this question might play out.

I also believe Section 53-12-82 for a QTIP provides a much stronger argument in contrast to the IRS asserting the SLAT limited power of appointment triggers Code Section 2036 inclusion of the SLAT trust value in the settlor-spouse's estate. This distinction goes, by relevant analogy, to the last section of Rev. Rul. 2004-64 (dealing with a trustee's discretion to reimburse a trust settlor for tax payment funds). This last section of Rev. Rul. 2004-64 states that Section 2036 may potentially apply to the trust if "applicable local law subject[s] the trust assets to the claims of [the settlor-spouse's] creditors".

Here is the kicker on my Section 2036 point. If in the SLAT situation there is evidence of a preexisting agreement that the limited power of appointment will be used for the benefit of the settlor-spouse, such as in emails, memos, letters, notes, cash-flow projections, etc., than I believe that evidence greatly augments a creditor’s assertion that the SLAT is a "self-settled" trust; with the result that a creditor *today* could obtain a garnishment judgment and then sit and wait (even for years) before any

distributions are made to the settlor-spouse. This creditor-reach could trigger also a surprising, and painful, Section 2036 trap.

By contrast, the express statutory protection for a secondary QTIP interest under the above Section 53-12-82 is sanctioned by statute. I do not believe -- even with an abundance of emails, memos, notes, etc., that a creditor can assert *today* — by reference to the secondary QTIP provisions — that the QTIP trust is self-settled. The creditor has to wait until later when any actual distributions are made to the settlor-spouse before trying to get a grab, or foot in the court's doorway, including problematic statutes of limitation for the creditor, etc. This unavailable reach by a creditor cuts against the above Section 2036 threat.

Point Two. *The October 15 QTIP Trust Marital Deduction Election.*

This is a brief point. An element I really like about the *Inter-vivos* QTIP is that the election to claim a QTIP marital deduction does not have to be made until the due date of the gift tax return, which in most cases can be extended until October 15 of the year *following* the calendar year of the gift. For example, the election to claim a QTIP marital deduction for an *Inter-vivos* QTIP trust gift today in 2022 is not required until (duly-extended) October 15, 2023. This provides much greater wait-and-see time to see whether Congress reduces the estate / gift exemption and whether any such changes are retroactive. By contrast, there is no election period for a SLAT. The SLAT, therefore, has no wait-and-see gifting flexibility

Conclusion

I recommend use of an *Inter-vivos* QTIP trust as an excellent preventive planning option in the event Congress during 2022 reduces the estate / gift exemption. Even aside from any threat of a reduction I believe the *Inter-vivos* QTIP is one of the most effective, flexible options for a married couple and their family. There is an abundance of information on the web about use of an *Inter-vivos* QTIP trust. An excellent resource also is Internal Revenue Service Private Letter Ruling 200413011 that includes a thorough, in-depth discussion of many of the components for the *Inter-vivos* QTIP design I recommend and use. I will be glad to email a copy of this IRS letter ruling to you at your request.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

James M. Kane

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CITATIONS:

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[i] **Steve Akers** at **Bessemer Trust** recently was very kind (and as always expertly thorough) to provide me with his summary of states that at present have protective statutes for *inter vivos* QTIP trusts, similar to the Georgia statute I discuss in this newsletter. Steve Akers' listing of these 18 states is: Arizona, Arkansas, Delaware, Florida, Georgia, Kentucky, Maryland, Michigan, New Hampshire, North Carolina, Ohio, Oregon, South Carolina, Tennessee, Texas, Virginia, Wisconsin, and Wyoming. Steve discussed this secondary QTIP interest in his summary of the ACTEC 2020 Annual Meeting.

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