

**Take-Away:** Some married individuals who want to adopt estate planning strategies to transfer wealth at little or no transfer tax exposure might want to take a look at a *remainder purchase marital trust* while prevailing interest rates are, relatively speaking, high.

**Background:** Specific estate planning strategies change with prevailing interest rates. As we are in a period of *relatively* higher interest rates, some wealth transfer planning strategies become more effective, like a qualified personal residence trust, or QPRT, where the higher the IRC 7520 rate, the greater the value of the current use of the residence, and thus the lower the value of the future remainder interest. The higher the interest rate and the longer the term, the lower the present value of the remainder, which can result in a lower value that is ultimately transferred and subject to the federal gift tax. This same outcome can apply to other wealth transfer strategies, too.

One such strategy is the *remainder purchase marital trust*. This wealth-shifting strategy involves the transfer of property to a ‘marital’ Trust for the donor’s spouse’s benefit which is designed to qualify for the federal gift tax marital deduction, yet the transferred assets held in that ‘marital’ Trust will not be subject to federal estate taxes on the beneficiary-spouse’s death. The result is that the transferred property ultimately passes to the donor’s children (or grandchildren) free of any federal gift or estate tax.

**Trust Basics:** A *remainder purchase marital trust* (or, for convenience, a RPMT) is set up with the following steps.

- (i) The donor transfers assets to a ‘marital’ Trust under which the donor’s spouse has an interest, either an income interest or an annuity interest, either for a specified term of years or for the spouse’s life.

- (ii) At the time, the ‘marital’ Trust is created by the donor-spouse, the donor-spouse also creates and funds a ‘children’s’ Trust,, which is a taxable gift.
- (iii) The ‘children’s’ Trust purchases the remainder interest in the ‘marital’ Trust from the donor-spouse.
- (iv) The ‘marital’ Trust’s assets then pass (usually on the spouse’s death) to the Trust that is established for the donor’s children or grandchildren- maybe a *dynasty*-type of Trust where the donor’s GST exemption is used.
- (v) The donor’s spouse’s interest in the ‘marital’ Trust will qualify for the federal gift tax marital deduction. [ See the discussion on IRC 2523(b) below.]
- (vi) The remainder interest acquired by the ‘children’s’ Trust is not a taxable gift because that Trust acquired the remainder interest by purchase; the remainder interest is not given to the ‘children’s’ Trust.
- (vii) When the beneficiary-spouse dies, the ‘marital’ Trust assets automatically pass to the ‘children’s’ Trust without any transfer tax consequence.

To achieve this result, the statutory language of IRC 2523(b) must be exploited.

**IRC 2523(b):** This Tax Code section provides that *no* gift tax marital deduction is allowed if, upon the occurrence of an event or on the lapse of time, the beneficiary-spouse’s interest in the transferred property will end, and as a result, the property passes to another person ***for less than adequate and full consideration in money or money’s worth.***” Consequently, the loss of the federal gift tax marital deduction for a transfer of property to a spouse of interests in property that lapses, thus causing the property to pass to another party on the termination of the beneficiary-spouse’s interest, *only* applies if that other party receives his/her interest for less than adequate consideration. With the RPMT strategy, the trust remainder holder pays the donor-spouse adequate consideration for its interest in the ‘marital’ Trust. Accordingly, by its terms, IRC 2523(b) will not apply because of the sale of the remainder interest, while the gift of the income or annuity interest in the ‘marital’ Trust to the beneficiary-

spouse will qualify for the federal gift tax marital deduction.

**Marital Trust Terms:** Under the 'marital' Trust, the beneficiary-spouse will not hold a general power of appointment over the Trust's assets. Nor will the donor make a QTIP election for the transfer to the 'marital' Trust. Because there is no general power, nor any QTIP election is made, the 'marital' Trust assets will not be included in the spouse's estate at his/her subsequent death, whether an income or annuity 'marital' Trust is used.

**Income RPMT:** Under this format, the beneficiary-spouse receives all trust income for a fixed term of years, either for the spouse's or the donor spouse's life, or for the shorter of the fixed term and life. The remainder interest in the 'marital' Trust is purchased by an irrevocable Trust that is created usually for the donor and spouse's children or grandchildren, such as a *dynasty*-type of Trust. All the capital appreciation on the 'marital' Trust's assets will pass to the 'children's' Trust free of gift or estate tax. However, some state's laws may require that the 'marital' Trust pay at least some of the income to the spouse, and these laws may give the spouse the right to recoup the minimum amount of income out of any capital gains if the trust does not, in fact, generate any income, e.g., unproductive real estate is held in the Trust, or artwork, where valuation discounts might be appropriately claimed. Even if the 'marital' Trust generates a modest amount of income, e.g., 1% to 2% a year, and such income is actually paid to the beneficiary-spouse as income) all growth in excess of that amount will pass to the remainder interest holder, i.e., the 'children's' Trust. The higher the interest rate when the 'marital' Trust is funded causes the value of the 'marital' Trust's remainder interest to be lower, thus reducing the purchase price that the 'children's' Trust must pay. To avoid risk of valuation issues when it comes to funding the RPMT, it might be wise for the donor-spouse to fund the 'marital' Trust with marketable securities or cash.

Compared to a grantor retained annuity Trust (GRAT,) the RPMT can transfer wealth more efficiently because with a GRAT the transfer of wealth to the GRAT's remainder interest holder is only the growth in

GRAT assets that is more than the IRC 7520 rate used when the GRAT was funded; the RPMT strategy does not require that the transferred property achieve any rate of return to be successful to transfer wealth tax-free.

**Annuity RPMT:** Under this format, the beneficiary-spouse receives an annuity for a fixed term of years, for the beneficiary-spouse's (or the donor-spouse's) life, or for the shorter term and life. Again, the remainder interest in the 'marital' Trust is purchased by the 'children's' Trust. The annuity can be structured so that the remainder value of the 'marital' Trust is minimized to significantly reduce the purchase price that must be paid by the 'children's' Trust. However, with the payment of an annuity amount only the growth of the 'marital' Trust property in excess of the IRC 7520 rate will be passed onto the 'children's' Trust tax-free, much like the GRAT's limitation.

**Conclusion:** If interest rates continue to remain relatively high and married individuals start to seriously think about the scheduled *sunset* of their currently large applicable federal transfer tax exemption, the RPMT strategy is just one more estate planning strategy to consider if their goal is to transfer wealth at a low, or no, transfer-tax cost.