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A Break from Tradition: Trust Planning for Wealthy Blended Families

Despite being separate and distinct from “family law,” estate planning techniques and strategies adapt not only to changes in tax law but also to the changing societal tides of what makes up a family.

While the nuclear family is still the norm, there are more and more blended families today, and the different family dynamics associated with blended families require estate planners to break from following the traditional estate plan usually implemented for nuclear families.

The Tax Cuts and Jobs Act (the “Act”) made numerous tax law changes affecting both businesses and individuals. The most relevant change affecting how wealthy individuals plan their estates is the practical doubling of the estate/gift tax and generation-skipping transfer (“GST”) tax exemptions to \$11.18 million per individual, \$22.36 million for married individuals.[1] In particular, this increase in exemptions is especially relevant to those wealthy individuals in blended family situations, in which case the traditional estate plan for married couples will neither achieve the equitable and adequate wealth transfer among the surviving family members nor result in the optimal use of these tax exemptions. Rather than follow the traditional plan, certain wealthy blended families should consider using an Inter Vivos qualified terminable interest property trust (“Inter Vivos QTIP Trust”) to achieve their wealth transfer and tax exemption utilization goals.

An Inter Vivos QTIP Trust is an irrevocable trust established by one spouse (typically the wealthier of the two), during his/her life, for the immediate and exclusive benefit of the other spouse. In order to qualify for qualified terminable interest property (“QTIP”) treatment, the terms of the Inter Vivos QTIP Trust must be as follows: (i) the other spouse must be the only beneficiary during his/her life, (ii) all of the income generated by the trust assets must be distributed to the other spouse at least annually, and (iii) there must be no principal distributions to anyone other than the other spouse during

his/her life. In addition to including these specific terms, a QTIP election must be made on a gift tax return filed for the year in which the initial transfer is made to the Inter Vivos QTIP Trust in order to receive QTIP treatment. The specific need for the Inter Vivos QTIP Trust will often dictate the amount of assets the wealthier spouse will transfer to it, but regardless of the amount, there is no gift tax due on the initial transfer to the Inter Vivos QTIP Trust because of the unlimited gift tax marital deduction. Finally, other than those specific terms required for QTIP treatment, the wealthier spouse is free to designate how the assets remaining in the Inter Vivos QTIP Trust upon the other spouse's death are to be disposed.

Most nuclear families, i.e., spouses in their first marriage with children from the marriage, have the same wealth transfer goals and thus implement the traditional estate plan for married couples: Upon the first death of either spouse (the "deceased spouse"), all assets are left to the survivor (the "surviving spouse"), typically in trust, for the remainder of his/her life, and then, transferred to the children, grandchildren, etc., upon the surviving spouse's death. On the other hand, most blended families, i.e., spouses in their second marriage with children from a prior marriage, have different wealth transfer goals than that of nuclear families. For example, each spouse may wish to provide, upon his/her death, for the surviving spouse *and* for his/her own children rather than provide for such children only after the surviving spouse's subsequent death. Implementing the traditional estate plan in a blended family situation would not achieve this wealth transfer goal because the children would not be provided for until the surviving spouse's death, which may occur much later, and more importantly, may not be adequately provided for at such time if the surviving spouse consumed most or all of the deceased spouse's assets during his/her lifetime. Instead, the wealthier spouse may transfer to an Inter Vivos QTIP Trust the amount of his/her assets necessary to generate enough income in order to provide for the other spouse's needs, which effectively allows for:

- The wealthier spouse to adequately provide for the other spouse both during his/her life and after the wealthier spouse's death,

- The wealthier spouse to control the disposition of the assets remaining in the Inter Vivos QTIP Trust upon the other spouse's death, and
- The wealthier spouse to retain the balance of his/her assets in order to also adequately provide for his/her own children upon his/her death.

In addition to achieving the desired wealth transfer among surviving family members, a common estate planning goal for all types of families is to maximize the use of both spouse's estate/gift tax and GST tax exemptions. Regardless of any wealth disparity between the two spouses, their estate tax exemptions may be fully utilized through the use of portability. However, if one spouse is wealthier than the other, there is potential for the GST tax exemption to not be fully utilized because portability is not available to be used for the GST tax exemption; that is, if the deceased spouse's assets are less valuable than his/her GST tax exemption upon death, the unused GST exemption will be wasted. To avoid wasting any GST tax exemption, the traditional estate plan would be for the wealthier spouse to immediately transfer to the other spouse, outright and free of trust, an amount of the wealthier spouse's assets that would make up for the amount of GST exemption that would otherwise be lost. Implementing this traditional plan, however, would strip the wealthier spouse's control over the disposition of the transferred assets upon the other spouse's death, which could potentially lead to a wealth transfer different from that desired by the wealthier spouse. Instead, the wealthier spouse may transfer to an Inter Vivos QTIP Trust the amount of his/her assets equal to the amount that the other spouse's assets falls short of his/her GST tax exemption, which effectively allows for:

- The income generated by such assets to provide for the other spouse's needs for life.
- The other spouse's GST tax exemption to be applied to the assets remaining in the Inter Vivos QTIP Trust upon the surviving spouse's death because of qualifying for QTIP treatment.

- The wealthier spouse controlling the disposition of the assets remaining in the Inter Vivos QTIP Trust upon the surviving spouse's death.

For more information, please contact [M. Todd Lewis](#) or any attorney in Frost Brown Todd's [Estate Planning & Administration](#) team.

[1] Tax Cuts and Jobs Act, H.R. 1, 115th Cong. (1st Sess. 2017).

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