

All in the happy blended family

Consider a QTIP trust or ILIT when estate planning for a blended family

No one said estate planning is easy, and this is especially true if you have a blended family. The good news is that there are two trust types — a qualified terminable interest property (QTIP) trust and an irrevocable life insurance trust (ILIT) — that can provide for your children from a previous marriage while also taking care of your current spouse and any children from your current marriage.

QTIP trust

At minimum, you should have a will in place that specifies how your wealth should be distributed. Otherwise, a significant portion of your estate may go to your children from a previous marriage — even if they're now adults and don't need the assets as much as your current spouse and children. If your children from a previous marriage are minors, your former spouse could end up with control of the assets — something you simply may not want to happen.

To implement your wishes for wealth distribution, you may find it helpful to establish a QTIP trust, one of the most effective estate planning tools available for blended families.

A QTIP trust qualifies for the estate tax marital deduction, meaning that assets you transfer to the trust aren't taxed when you die, and the entire amount is available for your spouse's support. (Note that, if your spouse isn't a U.S. citizen, he or she must take additional steps to shield the assets from taxes.) But unlike an ordinary marital trust, a QTIP trust can provide your spouse with income for life while preserving the principal for your children (from either your current or previous marriage, or from both) or other beneficiaries.

When your spouse dies, though, the trust assets will be subject to tax as part of his or her estate, even if the assets are to pass to your children as instructed in your will. If the value of your spouse's estate is greater than the lifetime exemption amount (currently \$3.5 million), the balance could be subject to hefty estate taxes.

ILIT

In some cases — particularly when one spouse is considerably younger than the other — a QTIP trust may not be the best solution. That's because the children from a first marriage, who may be much older than those from the second marriage, may have to wait years until the younger spouse dies and they can receive their inheritance.

In situations like this, an ILIT may be a better solution. The ILIT purchases life insurance on the older spouse, who makes annual exclusion gifts to the trust to cover the premiums. If the ILIT is designed properly, there won't be any estate tax on the insurance proceeds.

When the older spouse dies, the trust collects the death benefit and pays it out to the children from the first marriage. The older children receive their inheritance immediately, and the other assets remain available to provide for the younger spouse and children.

Besides allowing you to achieve a fair and balanced estate plan, life insurance can augment your estate, helping to ensure that there's enough wealth to go around. But keep in mind that, depending on how you and your spouse set up your estate

plans, if one of your taxable estates exceeds the estate tax exemption, some of your younger children's inheritance could be lost to estate tax. Careful planning for both spouses is critical.

Also think twice before transferring an *existing* insurance policy to an ILIT — if the insured spouse doesn't survive for at least three years after the gift, the proceeds of the policy will be included in his or her estate (assuming the transfer was a taxable gift).

Discuss your plans

Before choosing any estate planning approach, discuss your plans with your loved ones. Even if your plan is inherently fair, it may not be perceived that way without an explanation. In addition, consider the consequences of different wealth transfer strategies. QTIP trusts and ILITs are only two of the many tools available to control the distribution of your wealth in a way that minimizes taxes and maximizes benefits for everyone involved.