Allianz

Allianz Life Insurance Company of North America

LIFE ADVANCED MARKETS

Flexible estate planning strategies

The Clayton QTIP

One key factor to keep in mind as you consider plans for transferring wealth to the next generation, or passing on the family business, is this: **Change is inevitable.**

Your family dynamics may change, your personal financial needs may change, and tax laws may (and probably will) change. And there is one particular aspect of estate planning that is unique and simply unknown – the timing of when your strategy will go into effect (your death). These factors can create a moving target when it comes to developing an estate planning strategy, making it important to build in as much flexibility as possible.

One strategy for adding a level of flexibility is the Clayton QTIP (Qualified Terminable Interest Property) trust.[1]

Basic QTIP trust design

If your estate planning goals include providing annual income to your spouse for life and ensuring your children or other family members benefit from the estate you have built, then a QTIP trust may help to accomplish those goals.

A QTIP trust requires all trust income to be distributed to a surviving spouse (and solely to that spouse), during their life, on at least an annual basis. The remaining balance of the trust after the surviving spouse's death then passes on to designated beneficiaries (typically children or grandchildren). The grantor (the spouse who establishes the trust) is the only person who may decide who the remainder beneficiaries may be. The surviving spouse may not change who is to receive the remaining trust balance.

[1] IRC §2056(b)(7)

A QTIP trust may be established and funded during your lifetime or at your death. For example, a married individual may establish and fund a QTIP trust and have the trustee use a portion of trust principal to purchase cash value life insurance, such as a fixed index universal life (FIUL) insurance policy, on their life. The trustee may distribute income generated by other trust investments and/or may withdrawal cash value or take loans from the policy to generate additional income to the spouse if needed. This provides a level of flexibility as to when distributions are made as the trustee may decide when to take withdrawals or loans from the policy. When the grantor/insured passes away, the trust will receive the death benefit proceeds and the trustee may distribute trust income to the surviving spouse or make distributions to the grantor's chosen beneficiaries if the spouse has already passed.

The second option for incorporating a QTIP trust is to establish and fund the trust upon death. This could be done simply by providing in your estate planning documents directions that all, or a portion, of your estate is to be left to a QTIP trust. An alternative would be to acquire a cash value life insurance policy on your life with a QTIP trust named as the beneficiary. This would provide flexibility by allowing you to have access to policy cash values via withdrawals or policy loans during your life, while funding a QTIP trust with death benefits when you pass away.

The Clayton QTIP election

An alternative strategy that may add a level of flexibility would be to use what is referred to as a Clayton election.[2] Here is how such an election would work:

- Upon your death, your personal representative or estate executor is given the right to allocate your estate (including any death benefit proceeds) between one of two trusts – one that qualifies for the estate tax marital deduction (i.e., a QTIP election is made), and one that does not (no QTIP election).
- The amount passing to the non-QTIP trust will be subject to estate taxes, requiring the use of any available estate tax exemptions to avoid being taxed. With that in mind, the person provided with the right to choose the amount passing to each trust may elect to pass on an amount equal to your available estate tax exemption to the non-QTIP trust, with the remaining estate passing onto the QTIP trust. This would result in zero estate tax at your death.
- Both trusts may be designed to provide income to a surviving spouse. The QTIP trust must require all income be distributed to your spouse, while the non-QTIP trust may be more flexible and provide the trustee with more discretion.
- In the QTIP Trust, you would name the remainder beneficiaries prior to your death and that designation could not be amended after your death. In the non-QTIP trust, the remainder beneficiaries may be named by the surviving spouse.

Advantages

- When combined with a fixed index universal life insurance policy, this strategy provides financial security for a spouse while ensuring those you care for most will benefit from the wealth you have accumulated over a lifetime.
- When the FIUL policy is owned personally, the owner retains access to cash values that may be used for lifetime financial needs.
- When the trust is properly designed and a proper QTIP election is made, the initial transfer to the QTIP trust will qualify for the unlimited spousal exemption, thereby avoiding gift and estate taxes when transferred.
- The remaining balance in a QTIP trust is subject to estate taxes at the death of the surviving spouse; however, the remainder beneficiaries will receive a step-up in basis on property distributed from the trust.[2] In other words, capital gain property distributed to the remainder beneficiaries may be sold for little to no capital gains tax.
- With the Clayton election, the decision as to how to allocate your estate may be deferred until your death. **This provides an opportunity to make a more efficient allocation based on tax laws and family dynamics at that time.**

[1] The Clayton election is named for a strategy evaluated in Estate of Clayton, 976 F.2d 1486 (5th Cir. 1992). The IRS provided positive guidance on the strategy in Treas. Reg. §25.2518-2(e)(5), Example 5.

[2] IRC §1014

Considerations

- Withdrawals and/or loans taken from the FIUL policy for personal financial needs will reduce the amount of death benefit and therefore the amount passing on to beneficiaries.
- In a QTIP trust, all trust income must be distributed to the grantor's spouse during their life. Trust principal may be distributed to the surviving spouse only for their "health, maintenance, and support," and only if the income from the trust is not sufficient.
- The remaining property must be included in the gross estate of the surviving spouse when they pass away.
- The surviving spouse does not have the right to change who the remainder beneficiaries are or how much of the remaining trust property they receive.
- The trust may be designed to allow adult children to purchase specific property from the trust that they would like to retain. The trust may also specify which property is to be distributed to which children.
- Transfers to a QTIP trust are irrevocable.
- Selecting an appropriate trustee who is familiar with the intention of the grantor is important.
- If a Clayton election is to be used, electing the appropriate person to act as a personal representative or executor of your estate, and communicating your goals to them, is key.
- FIUL insurance requires qualification through health and financial underwriting.
- You should consult with your legal and tax advisors to address your specific needs and concerns if considering this strategy.

WORK WITH YOUR FINANCIAL PROFESSIONAL to learn how FIUL insurance can be a part of your flexible estate planning strategies.

The death benefit is generally income-tax-free when passed on to beneficiaries.

Policy loans and withdrawals will reduce the available cash value and death benefit and may cause the policy to lapse, or affect guarantees against lapse. Withdrawals in excess of premiums paid will be subject to ordinary income tax. Additional premium payments may be required to keep the policy in force. In the event of a lapse, outstanding policy loans in excess of unrecovered cost basis will be subject to ordinary income tax. If a policy is a modified endowment contract (MEC), policy loans and withdrawals will be taxable as ordinary income to the extent there are earnings in the policy. If any of these features are exercised prior to age 59½ on a MEC, a 10% federal additional tax may be imposed. Tax laws are subject to change and you should consult a tax professional.

This content is for general educational purposes only. It is not intended to provide fiduciary, tax, or legal advice and cannot be used to avoid tax penalties; nor is it intended to market, promote, or recommend any tax plan or arrangement. Allianz Life Insurance Company of North America, its affiliates, and their employees and representatives do not give legal or tax advice. Customers are encouraged to consult with their own legal, tax, and financial professionals for specific advice or product recommendations.

Guarantees are backed by the financial strength and claims-paying ability of Allianz Life Insurance Company of North America (Allianz). www.allianzlife.com

Products are issued by Allianz Life Insurance Company of North America, 5701 Golden Hills Drive, Minneapolis, MN 55416-1297. 800.950.1962. www.allianzlife.com