

# HOUSE RESEARCH

## Bill Summary

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This bill modifies the default rule that determines which heirs of an estate are responsible for paying the estate's federal and state estate tax obligations, if the will or trust documents do not provide who pays them (i.e., which bequest or share is reduced to pay the taxes).

Under present law, tax obligations are apportioned based on each heir's share of the total property of the gross estate. If an heir's (or a beneficiary's for a trust) share is one-quarter of the estate's property, then one-quarter of the estate tax (federal and state) would be apportioned to and would reduce that heir's bequest or share. These calculations are based on property in the gross estate and are not affected by how much that property actually contributes to the tax obligation (e.g., if the property is deductible in computing estate tax).

The bill changes that general rule for qualified terminable interest property (QTIP). (See below for a description of what QTIPs are and how they are used.) In essence, the new rule would provide that QTIPs pay the proportional amount of the estate tax that their inclusion in the taxable estate yields. That means that on the death of the first spouse, the nonelected portion of the QTIP (i.e., the part that qualifies for the marital deduction) would be apportioned no responsibility for paying estate taxes. On the death of the surviving spouse, the QTIP property would pay its proportionate share (based on the amount of property in the gross estate) of the marginal tax generated by the QTIP property. As noted above, this is a default rule; if the documents provide some other method of determining who pays the estate tax, that method would govern.

**Background on QTIPs.** QTIP trusts are a standard estate tax planning tool for married couples. They allow electing the amount of the trust that will qualify for the marital deduction under the federal estate tax (and typically under a state estate tax). The rest or nonelected part of the QTIP trust can be used to remove property from the estate of the surviving spouse for estate tax purposes, while still providing income to the surviving spouse and limiting to whom the property will ultimately go. QTIPs are most

## **Section**

commonly used in blended family situations, where there are children from a prior marriage and the individual wants preserve a portion of the estate for the children from the prior marriage, while providing support to the surviving spouse during his or her lifetime. Use of a QTIP allows doing that, while not losing the value of the marital deduction under the estate tax on the death of the first spouse.

To qualify as QTIP property, the federal estate tax law requires that:

- The property must be owned by the decedent
- The surviving spouse must have a right to all of the income, payable at least annually, from the property for life
- No one else may have a power of appointment over the property until the surviving spouse dies
- A QTIP election must be made