Department of Legislative Services

Maryland General Assembly
2013 Session

FISCAL AND POLICY NOTE

House Bill 859 (Delegate Waldstreicher)
Judiciary Judicial Proceedings

Interests in Grantor and Qualified Terminable Interest Property Trusts

This bill specifies that an individual who creates a "grantor" trust or a specified qualified terminable interest property (QTIP) trust is not considered the settlor of the trust with regard to certain interests and that a creditor of the individual may not attach, exercise, reach, or compel distribution from the trust or certain other trust property attributable to a specified QTIP trust.

Fiscal Summary

State Effect: The bill is not expected to have a direct, material impact on State finances.

Local Effect: None.

Small Business Effect: None.

Analysis

Bill Summary: An individual who creates a trust is not considered the settlor of the trust with regard to the individual's interest in the trust if the interest is the authority of the trustee to pay or reimburse the individual for any tax on trust income or trust principal payable by the individual under the law imposing the tax. In addition, an individual who creates a trust is not considered the settlor of the trust with regard to the individual's interest in the trust if the trust is a QTIP trust under the Internal Revenue Code created for the benefit of the individual's spouse and the individual's interest in the trust income, trust principal, or both follows the termination of the spouse's prior interest in the trust.

A creditor of such an individual may not attach, exercise, reach, or otherwise compel distribution of:

- any principal or income of the trust;
- any principal or income of any other trust to the extent that the property held in the other trust is attributable to a QTIP trust created by the individual as described above;
- the individual's interest in the trust; or
- the individual's interest in any other trust to the extent that the property held in the other trust is attributable to a QTIP trust created by the individual as described above.

The bill may not be construed to affect any State law with respect to a fraudulent transfer by an individual to a trustee.

Current Law/Background: The Internal Revenue Code allows for certain tax treatment of "grantor trusts" and QTIP trusts. In the case of grantor trusts, under circumstances specified in the code, where the grantor (creator of the trust) or another person is treated as the owner of any portion of the trust, items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust are included in computing the taxable income and credits of the grantor or other person. An Internal Revenue Service (IRS) revenue ruling (Rev. Rul. 2004-64) indicates that where a trustee has discretion to reimburse the grantor for income tax liability attributable to the inclusion of all or part of the trust's income in the grantor's taxable income, the trustee's discretion to do so does not alone cause the inclusion of the trust in the grantor's gross estate for federal estate tax purposes.

With respect to a QTIP trust, qualified terminable interest property, under the Internal Revenue Code, is property which passes from the decedent in which the surviving spouse has a qualifying income interest for life. Such property is treated as passing to the surviving spouse for purposes of the federal estate tax marital deduction. "Qualifying income interest for life" means (1) the surviving spouse is entitled to all the income from the property, payable annually or at more frequent intervals, or has a right of use and enjoyment for life in the property and (2) no person has a power to appoint any part of the property to any person other than the surviving spouse, with the exception of a power exercisable only at or after the death of the surviving spouse. Maryland law also allows for an election to treat property as marital deduction qualified terminable interest property in calculating the Maryland estate tax, whether or not an election was made for the same decedent for federal estate tax purposes.

A Treasury regulation indicates that where an individual creates a QTIP trust during the individual's lifetime for the individual's spouse, the individual's spouse then dies before the individual, and the terms of the trust provide for the trust income to be paid to the individual for life in the event that the spouse dies before the individual, the trust is not subject to inclusion in the gross estate of the individual upon the individual's death if the trust was included in the gross estate of the spouse. *See* Treas. Reg. § 25.2523(f)-1(f)(Example 11).

The Estate and Trust Law Section of the Maryland State Bar Association suggests that recent developments in the law relating to whether creditors can reach certain interests of a creator of a trust could change the apparent IRS view that the above-mentioned retained interests do not cause the trust property to be subject to estate tax as part of the estate of the creator of the trust.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller's Office, Judiciary (Administrative Office of the Courts), Register of Wills, Maryland State Bar Association (Estate and Trust Law Section), Internal Revenue Service, Department of Legislative Services

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mc/kdm

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