

The QTIP Trust – Where Does it Fit into Farm Estate and Succession Planning?

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Overview

For agricultural families, a farm is rarely just a business or an investment portfolio; it is an irreplaceable legacy. It represents generations of sweat equity, deep ties to the local community, and a unique way of life. However, passing a farming operation to the next generation introduces an incredibly complex web of challenges. Farmers must balance volatile commodity markets, capital-intensive asset bases, shifting tax legislation, and deeply emotional family dynamics.

One of the most persistent dilemmas in farm succession planning occurs when a landowner wants to ensure their surviving spouse is fully provided for, while simultaneously guaranteeing that the land itself - the core operational engine of the farm - remains intact and passes exclusively to the next generation of operators. This challenge becomes acutely sensitive in blended families, or in scenarios where a surviving spouse might later remarry. Without a deliberate structural safeguard, a multi-generational farm can easily leak away through a second marriage, out-of-family inheritance, or forced liquidation.

To bridge this gap, sophisticated agricultural estate planners frequently turn to a powerful estate planning vehicle: the Qualified Terminable Interest Property (QTIP) Trust. What is it? How does it function? And how can it secure both a surviving spouse's future financial security and comfort, and grant lifetime access to the farm's value, without giving them the power to accidentally or intentionally transfer the land out of the bloodline so that the family's agricultural legacy is preserved?

What is a QTIP Trust?

Defined. QTIP trust is an irrevocable trust established by one spouse (the grantor) for the benefit of the other.¹ For federal estate and gift tax purposes, transfers of property between spouses are shielded by the unlimited marital deduction.² Normally, to qualify for this deduction, assets must be given to the surviving spouse outright or through a structure that grants them total control over where the assets go next.

The QTIP trust is a highly specific exception to this rule. It allows the grantor to qualify the transferred assets for the unlimited marital deduction, delaying any potential federal estate tax until the death of the *surviving* spouse, while retaining absolute control over the ultimate disposition of the asset. The surviving spouse receives a lifetime income interest from the trust, but they never own the principal assets directly, and they cannot dictate who inherits those assets when they pass away. Instead, the final beneficiaries (known as the remainder beneficiaries)—typically the children or active farming heirs - are locked in by the grantor from the very beginning.

¹ QTIP trusts are authorized under I.R.C. §2056(b)(7).

² I.R.C. §2056 (federal estate tax marital deduction); I.R.C. §2523 (federal gift tax marital deduction).



Qualification. To qualify as a QTIP trust, several strict statutory conditions must be met:

- **Lifetime Income:** The surviving spouse must be entitled to all the income generated by the trust property, payable at least annually, for the remainder of their lifetime.
- **No Power of Appointment:** No person, including the surviving spouse, can have the power to appoint any part of the trust property to anyone other than the surviving spouse during that spouse's lifetime.
- **Executor Election:** The executor of the deceased spouse's estate must make a formal, irrevocable election on the federal estate tax return (Form 706) to treat the property as a QTIP.

The Strategic Value of a QTIP Trust in Agricultural Succession

Applying a QTIP trust to a farm estate offers distinct structural advantages that address the intersection of family relationships and asset protection.

Protection against blended family disinheritance. Blended families are common, but they add layers of complexity to farm succession. For example, assume that farmer Bob outlived his wife and survives along with children from the marriage. Bob remarries later in life to Lucinda, a widow. Bob wants to ensure that Lucinda is well taken care of if Bob dies first. However, if he leaves the land to the Lucinda outright, there is a substantial risk that she will eventually leave the farm to her children from her prior marriage completely bypassing the original farming heirs who grew up working the land.

By placing the farm real estate into a QTIP trust, Bob eliminates this risk. Lucinda enjoys the economic benefits of the farm for life, but upon her death, the trust dictates that the land transfers automatically to Bob's children. Lucinda cannot alter this path, regardless of pressure from her own children or changes in personal relationships.

Safeguarding against remarriage risks. Even in traditional, first-marriage scenarios, a QTIP trust provides critical protection against subsequent remarriage. As noted in the example above, if a surviving spouse inherits valuable farm ground outright and later remarries, that land becomes exposed to the new spouse. If the surviving spouse predeceases or if the second marriage ends in divorce, the multi-generational farm can become marital property subject to division or out-of-family inheritance. The QTIP structure completely walls off the farmland from the claims, debts, or inheritance rights of any future spouse.

Example: Outright vs. QTIP Structure

- **Scenario A (Outright Gift):** John dies and leaves his 1,200-acre farm directly to his wife, Mary. Two years later, Mary marries Robert. Mary passes away ten years later, leaving her entire estate to Robert. Robert has no ties to agriculture and subsequently sells the land to a commercial developer. John's children, who operate the farm, lose their primary acreage.



- **Scenario B (QTIP Trust):** John places the 1,200-acre farm to a QTIP Trust. Upon John's death, Mary receives all annual cash rents and profits from the farm for life. Robert has no claim to the property. When Mary passes away, the trust terminates, and the 1,200 acres transfer directly to John's farming children, completely unencumbered and intact.

Managing on-farm vs. off-farm heir divide. One of the hardest parts of farm succession is treating children fairly when some choose to operate the farm (the on-farm heirs) and others pursue off-farm careers (the off-farm heirs). A QTIP trust can act as a stabilizing mechanism during the transitional generation. While the surviving spouse is alive, the active farming children can lease the land from the trust at a fair market or family-discounted rate, generating the mandatory income required for the spouse. The trust terms can even grant the farming heirs specific rights of first refusal or options to purchase fractional interests from the trust over time, ensuring operational continuity while protecting the financial peace of the widow or widower.

Navigating the "Productive Property" Mandate

While a QTIP trust offers remarkable benefits, agricultural estates present a specific legal hurdle: the requirement that the trust property must generate income for the surviving spouse. Under the Treasury Regulations, a surviving spouse has the legal right to compel the trustee to make the trust property productive or convert non-income-producing property into income-producing property within a reasonable timeframe.³

Observation: When evaluating agricultural assets for a QTIP election, the interaction between the asset's nature and the regulatory thresholds is critical. If a farm's primary value is in equity (land appreciation) rather than annual yield, it may be characterized as "substantially unproductive" for marital deduction purposes. For example, the IRS has ruled that a trust funded with a remainder interest in timberland did not qualify for the QTIP deduction because the trust instrument specifically prohibited the spouse from compelling the trustee to convert the timberland into income-producing property.⁴ To preserve the deduction, the trust instrument or local law must grant the spouse the power to compel productivity. For example, if the farm value is \$5,000,000 but generates \$0 income, and the spouse is legally barred from demanding a sale or lease to generate income, the entire \$5,000,000 value is excluded from the marital deduction, potentially triggering immediate estate tax at the first spouse's death

This poses a unique challenge for a farm. Agricultural land value is heavily concentrated in equity, while annual cash yields can be low or highly volatile. If a farm experiences consecutive lean years, or if the farm consists of raw, undeveloped pasture ground that isn't actively leased, the surviving spouse could legally demand that the trustee sell off pieces of the land to reinvest the proceeds in high-yielding equities or bonds. For a farming family, selling the ground is exactly what they are trying to avoid.

³ Treas. Reg. §20.2056(b)-5(f)(4) (a power granted to a trustee to retain unproductive property will not disqualify the interest if the rules for trust administration require, or permit the spouse to require, that the trustee either make the property productive or convert it into productive property within a reasonable time; however, if the primary purpose of the trust is to safeguard property without providing the spouse the required beneficial enjoyment (e.g., if the spouse cannot compel the conversion of unproductive assets), the interest fails to qualify for the marital deduction).

⁴ Tech. Adv. Memo. 9717005 (Dec. 18, 1996).



To mitigate this risk, one approach is to carefully structure the trust to allow for flexible lease arrangements. Consider the following possibilities:

- **Cash Rent Agreements:** The trust could allow the farm to be leased to the operating heirs or an outside party via a formal cash rent agreement. This guarantees a steady, predictable annual stream of income directly to the trust to satisfy the spouse's life estate, protecting the underlying principal asset from a forced sale.
- **Crop-Share Adjustments:** While crop-share arrangements are traditional, they are subject to weather and market fluctuations. If crop-sharing is utilized, the trust should include provisions allowing the trustee to smooth out distributions or utilize alternative trust funds to maintain consistent payouts to the spouse.

Tax Advantage - The "Double-Step-Up" in Basis

Beyond asset protection and family harmony, the QTIP trust provides the potential the potential for a "double-step-up" in cost basis for capital gains purposes. Upon the death of the first spouse and the movement of the farm assets into the QTIP trust, those assets receive an initial step-up in basis to fair market value.⁵ With the estate's QTIP election, the asset qualifies for the marital deduction and avoids estate taxation at that time.

Crucially, because the assets of a QTIP trust are required by law to be included in the gross estate of the *surviving* spouse upon their subsequent death,⁶ the property qualifies for a *second* step-up in basis upon the surviving spouse's death. For heirs inheriting farmland that has appreciated over decades, this double-step-up can virtually eliminate capital gains tax liability if the children eventually decide to sell sections of the land or equipment.

Conclusion

A multi-generational farm is a dynamic enterprise built on tradition, hard work, and valuable real estate. Protecting it requires looking ahead and planning for major family transitions. The QTIP trust provides a vital bridge in this planning process, offering a compromise that protects the surviving spouse for life while simultaneously protecting the farm assets for the on-farm heirs of the pre-deceased spouse.

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⁵ Under I.R.C. §1014 the trust assets are included in the deceased spouse's estate and receive a basis equal to fair market value at that time.

⁶ I.R.C. §2044.

