

Joint revocable trusts have been used historically as a mechanism for married persons to combine assets and control their disposition in a uniform manner. Estate planning attorneys in community property jurisdictions routinely have drafted joint revocable trusts to take advantage of the unique “double basis” benefit of community property on the death of the first spouse under Code § 1014(b)(6), which “steps up” the basis of the entire property, even though only one-half of the property is included in the predeceasing spouse’s estate for estate tax purposes. In noncommunity property jurisdictions, joint revocable trusts are being used increasingly to facilitate full use of the federal applicable exclusion amount regardless of which spouse is the first to die, particularly when the combined assets of the marital unit exceed the federal applicable exclusion amount but the individual assets of one spouse or both spouses do not meet or exceed the federal applicable exclusion amount. In TAM 9308002, the taxpayers in a common law jurisdiction attempted to get a full “step-up” in basis, similar to the treatment received in community property. The IRS denied the full “step-up” in basis based on Code § 1014(e). Similar joint revocable trusts in common law jurisdictions were discussed in two private letter rulings, PLR 200210051 and PLR 200101021. Although the IRS maintains that Code § 1014(e) prevents a full “step-up” in basis, the joint trust has favorable results for funding a credit-shelter trust on the death of the first spouse to die. At a recent Philadelphia Estate Planning Council meeting, Professor Jeffrey N. Pennell commented that the IRS will most likely write a revenue ruling in the next two years giving more guidance in the area.



This article reviews the utility of a joint revocable trust that creates a credit shelter trust equal to the maximum federal applicable exclusion amount and a residuary marital trust for the balance on the death of the first spouse to die. It addresses a variety of gift, income, and estate tax issues and offers some practical drafting and administration advice. For a detailed analysis of a variety of other joint trust applications, see John H. Martin, *The Joint Trust: Estate Planning in a New Environment*, 39 Real Prop. Prob. & Tr. J. 275 (2004).

Terms of Sample Joint Revocable Trust

Although a myriad of provisions may be incorporated to customize a joint revocable trust, including variations on the general powers of appointment granted to the predeceasing spouse, for purposes of this article the following terms will be deemed to control the joint revocable trust (JRT). Husband and wife will be the sole grantors and sole co-trustees of the JRT. Each will contribute 50% of the assets to the JRT, consisting of property currently held as tenants by the entirety and individually. To equalize individually held assets, such as a marketable securities account, up to 50% of the asset will be transferred to the other spouse's individual name, and 50% of such asset will be held in each of two separate accounts, one in the name of each spouse, and then the husband and wife will contribute their equal separate accounts to the JRT. The JRT may be amended during the joint lifetime of the husband and wife only by unanimous consent. Each spouse, however, will be given the power to terminate the trust at any time before the death of the first of them to die and to have

Beth A. Turner is a member in the Charlotte, North Carolina, office of Moore & Van Allen PLLC.

50% of the JRT assets returned at that time to each spouse. During the joint lifetime of the husband and wife, the trustees will be authorized to distribute income and principal to either or both of the grantors in the trustees' sole discretion or as directed by an instrument executed by both of the grantors.

On the death of the first spouse (the "predeceasing spouse"), he or she will have a general testamentary power of appointment over the entire JRT assets allowing the predeceasing spouse to appoint the entire trust property to or among himself or herself, to his or her creditors, to his or her estate, or to the creditors of his or her estate. The trust becomes irrevocable on the death of the pre-

deceasing spouse. A credit shelter trust (the "Family Trust") will be funded on the death of the surviving spouse with assets equal to the maximum federal applicable exclusion amount then in effect (currently \$1.5 million, but scheduled to increase to \$3.5 million by year 2009) based on a fractional formula (after taking into consideration any taxable lifetime gifts). The spouse who survives the predeceasing spouse (the "surviving spouse") will be the primary benefi-

ciary and sole trustee of the Family Trust, and the children of the grantors will be secondary beneficiaries of the Family Trust. Distributions from the Family Trust will be limited to an ascertainable standard (health, support, maintenance, and education, for example). On the death of the surviving spouse, he or she will have a limited power of appointment over the remaining Family Trust assets and may appoint the remaining trust assets to or among the common descendants of the original grantors. Any Family Trust property not so appointed by the surviving spouse will be distributed outright to the common descendants of the initial grantors who are then living, per stirpes. It should be noted that this JRT could be drafted to incorporate trusts for children and generation-skipping transfer tax trusts.

The balance of the JRT assets not used to fund the Family Trust will be held in a marital trust for the sole benefit of the surviving spouse (the "Marital Trust") qualifying for the federal estate tax marital deduction. The surviving spouse will be the sole trustee of the Marital Trust. Income will be paid at least quarter-annually and principal will be payable in the trustee's discretion. The surviving spouse will have a testamentary general power of appointment over the Marital Trust assets.

Again, any Marital Trust property not so appointed by the surviving spouse will be distributed outright to the common descendants of the initial grantors who are then living, per stirpes.

Gift Tax Issues on Funding and Until Death of Predeceasing Spouse

Treas. Reg. § 25.2511-2(b) provides that a gift is complete as to any property, or part therein, of which the

Joint Revocable Trusts

New Flexibility in an Old Form

By Beth A. Turner

donor has so parted with dominion and control as to leave him or her no power to change its disposition, whether for his or her own benefit or for the benefit of another. Treas. Reg. § 25.2511-2(c), however, provides that no gift is complete when a donor reserves the power to revest the beneficial title to the property to himself or herself. Under the sample JRT, because each grantor retains the power to terminate the JRT and have 50% of the JRT assets returned to each spouse, there is no completed gift on funding of the JRT by either spouse.

Until the death of the predeceasing spouse, any distribution from the JRT, including the distribution of the JRT assets on the termination of the trust, will result in a completed gift from the nonrecipient spouse to the recipient spouse to the extent that the property received in the distribution was not property contributed to the trust by the recipient spouse. The gift will, however, qualify for the gift tax marital deduction under Code § 2523.

Gift and Estate Tax Issues on Death of Predeceasing Spouse

The trust becomes irrevocable on the death of the predeceasing spouse. Under both previously cited private letter rulings, immediately preceding the death of the predeceasing spouse there is a completed gift from the surviving spouse to the predeceasing spouse of all of the JRT property that is eligible for the gift tax marital deduction. This deemed gift is relevant as it is essential that the predeceasing spouse be the transferor of all assets used to fund the Family Trust to counter any assertion that the surviving spouse was a transferor of such assets, thus causing inclusion of the assets in the surviving spouse's estate on his or her subsequent death. Furthermore, transfers from the Family Trust to beneficiaries other than the surviving spouse (children and grandchildren, for example) will not be deemed to be gifts

from the surviving spouse to such other beneficiaries. Finally, the Family Trust assets will not be included in the surviving spouse's gross estate provided that a prohibited interest is not retained by the surviving spouse in the Family Trust (the surviving spouse will not be given a general power of appointment over the Family Trust assets and distributions to the surviving spouse will be limited by an ascertainable standard).

For estate tax purposes, the entire value of the JRT assets are included in the gross estate of the predeceasing spouse under Code §§ 2038 and 2041. Code § 2038(a) provides in part that the value of the gross estate of a decedent includes the value of all property of which the decedent at any time has made a transfer (except in the case of a bona fide sale for adequate and full consideration) when the enjoyment thereof was subject at the date of death of the decedent to any change through the exercise of a power by the decedent to alter, amend, revoke, or terminate the interest or when the decedent has transferred such power within three years of his or her death. Under the sample JRT, each spouse is given the power to terminate the trust at any time before the death of the first of them to die and to have 50% of the JRT assets returned to each spouse. As a result, 50% of the assets will be pulled into the estate of the predeceasing spouse under Code § 2038.

The balance of the JRT assets will be included in the gross estate of the predeceasing spouse under Code § 2041, which provides that the value of the gross estate will include the value of all property to which the decedent possesses, at the time of death, a general power of appointment. Under the sample JRT, the predeceasing spouse is given the power to appoint the JRT assets to or among himself or herself, to his or her creditors, to his or her estate, or to the creditors of his or her estate. Therefore, any assets not already included under Code § 2038 will be included in the gross estate of the

predeceasing spouse under the general power of appointment provisions contained in Code § 2041.

Income Tax Consequences

Code § 1014(a) provides that the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent is the fair market value of the property at the date of the decedent's death (or alternate valuation date). The "step-up" in basis under Code § 1014(a) is disallowed, however, under Code § 1014(e), if appreciated property is acquired by the decedent by gift during the one-year period before the decedent's death and the property is acquired from the decedent by, or passes from the decedent to, the donor of such property. Under such scenario, the basis in the hands of the original donor is the adjusted basis of the property in the hands of the decedent immediately before the death of the decedent.

Under the terms of the JRT, the surviving spouse is deemed to make a gift of all assets to the predeceasing spouse immediately before the death of the predeceasing spouse. Therefore, only the assets contributed by the predeceasing spouse to the JRT are eligible for a basis step-up under Code § 1014(a), as the assets contributed to the JRT by the surviving spouse were not the result of a completed gift within the one-year period ending one year before the predeceasing spouse's death. Although PLR 200210051 and PLR 200101021 specifically do not address the issue of asset tracing, as a practical matter, to ensure proper step-up in basis of the assets of the predeceasing spouse, it is imperative that the origin of the assets to the JRT on funding be ascertainable. As suggested above, to the extent possible, each grantor should contribute 50% of each of the assets to the JRT. Otherwise, tracing the origins of the assets could be administratively burdensome to ensure that the maximum amount of step-up in basis is achieved on the death of the predeceasing spouse.

Although some commentators have dismissed the utility of the joint revocable trust based on the disallowance of a full step-up in basis for all of the trust assets, as occurs in community property jurisdictions, the grantors are in no worse position for having contributed the assets to a joint revocable trust as opposed to a traditional trust because, according to the previously cited private letter rulings, the permissible step-up in basis is limited to assets deemed to be held in the individual's sole name. A more aggressive stance, not substantiated by the private letter rulings, would be that all of the assets used to fund the Family Trust receive a step-up in basis on the death of the predeceasing spouse, because the assets subject to the general power of appointment of the predeceasing spouse are not returned outright to the surviving spouse but instead are held in trust for the benefit of the surviving

spouse and/or descendants and the distribution of such assets is subject to an ascertainable standard.

Drafting Considerations

Although the joint revocable trust technique may not be appropriate for all clients, a great deal of flexibility can be incorporated into the trust document itself to accommodate the unique facts and circumstances of many clients. Depending on marital accord or discord, as the case may be, a joint revocable trust for tax planning purposes may be formulated granting either extremely broad or extremely narrow testamentary general powers of appointment. The Marital Trust either can be restrictive in nature or eliminated altogether by providing that assets not used to fund the Family Trust will be distributed outright to the surviving spouse. In addition, when it is desirable, successive trusts for children

and/or generation-skipping transfer tax trust provisions can be easily incorporated into the overall plan. Finally, when assets were acquired in both community property jurisdictions and noncommunity property jurisdictions, it is important that the joint revocable trust be drafted to preserve the integrity of the community property assets and that such assets be identifiable.

Conclusion

The joint revocable trust is an effective tool for ensuring that the maximum federal applicable exclusion amount is used on the death of the predeceasing spouse while offering a gamut of optional language to accommodate the unique circumstances of any particular married couple. This technique should, however, be reserved for well-advised clients who have examined all of the estate, gift, and income tax implications. ■