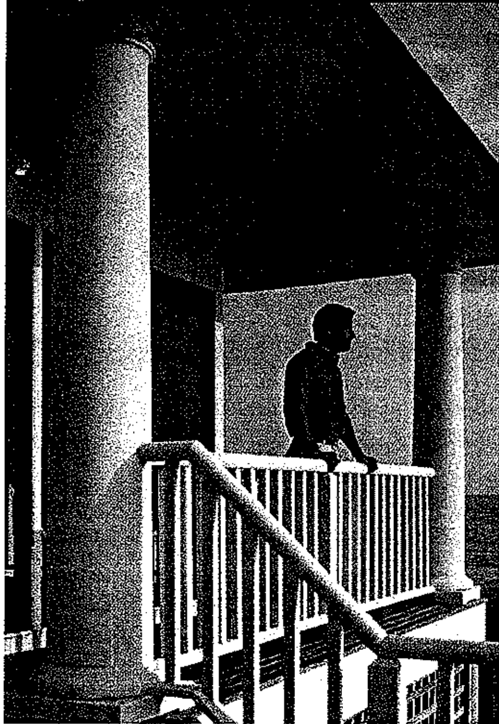

Joint Trusts Revolutionize Estate Planning for Retirement Assets & Estates Under $3,000,000 for Couples

Part I: The Challenge of Estate Planning for Estates Under $3,000,000 with Large Qualified Plans in an Era of Rising Estate

By Leo J. Cushing, Esq., CPA, LLM
Melissa S. Conover, Esq.

The federal government has implemented new estate tax exemptions currently set at $1,500,000 in 2004 and rising to $3,500,000 in 2009. For one year, in 2010, there will be no federal estate tax but, in 2011, the exemption will be brought back to $1,000,000.

There is now federal legislation pending that either will eliminate the federal estate tax entirely (not a likely scenario) or at least increase the exemption to $3,500,000 per person permanently (a more likely scenario).

Massachusetts has also been busy on the estate tax front by reinstating the death tax. For deaths occurring on or after January 1, 2003, Massachusetts has implemented a new estate tax system with its own set of exemptions, currently set at $850,000 and rising only to $1,000,000 in 2006.

Retirement-plan assets present a perplexing problem for estate-planners. While retirement plans can be made payable to a credit shelter trust, it is preferable that they be payable to the surviving spouse to minimize income taxes. Stock options, incentive stock options and restricted stock may or may not be permitted to be held by or payable to a trust, so must be made payable to the spouse. How, then, should the decedent's exemption be fully utilized? These are questions the estate planner must face every day in every case, regardless of the size of the couple's estate.

Another dilemma is how to make complex planning simple and cost effective in such an uncertain legislative world. Until now, this goal was almost impossible to obtain. Two new rulings from the Internal Revenue Service, however, will revolutionize estate planning for smaller estates and solve the problem of estate planning for retirement assets. Let's take a look at a couple of examples.

First, consider the case of the married couple with total assets of $2,000,000 consisting of their home worth $1,000,000 and cash and marketable securities worth $1,000,000. All of their assets are owned jointly. The usual estate plan would involve the establishment of two separate revocable trusts, one for each spouse. The assets would then be split equally so that $1,000,000 worth of assets would be owned by the husband's trust and $1,000,000 would be owned by the wife's trust. If, however, the husband dies first in 2004, his credit shelter trust would be funded with the assets in his trust equal to $1,000,000, resulting in an underutilization of his federal estate tax exemption amount, currently set at $1,500,000.

It clearly would be preferable to have the decedent's by-pass trust funded with the maximum amount of $1,500,000, regardless of which spouse dies first, thereby assuring that these assets will escape taxation in the future upon the death of the surviving spouse. This is particularly important in light of the fact that, should there be a death between now and 2010, the goal would be to have all of the assets allocated to the by-pass share to escape estate taxation upon the death of the survivor, remembering that the current increasing exemptions will sunset on December 31, 2010 and will return to $1,000,000.

Another challenging estate planning situation is presented when the couple has a large retirement account. The most favorable income tax solution would be to have the surviving spouse roll the decedent's IRA account balance into a spousal rollover, but this is inconsistent with good estate planning since the decedent's credit shelter amount will be unused. One widely used solution is to have the IRA account owner designate the surviving spouse as the primary beneficiary with the taxpayer's by-pass trust listed as the contingent beneficiary in the event the surviving spouse disclaims any portion or all of the retirement benefit. This technique allows the surviving spouse to take a second look to re-evaluate his or her situation following the death of the account owner, in order to obtain the best of all possible worlds. It is important that the nine-month limitation within which to file a disclaimer not be forgotten and all conflict of issue questions resolved when utilizing this approach.

The joint trust technique will assure full utilization of the applicable exclusion amount upon the death of the first spouse to die, regardless of which spouse dies first, and permit the most favorable income tax treatment attributable to retirement plan assets and other assets that do not lend themselves to funding a by-pass trust, such as restricted stock, stock options and incentive stock options.

Consider the case of a married couple with combined assets of $3,000,000, with $1,500,000 in the husband's IRA and $1,500,000 consisting of other jointly owned assets. As the federal exemption amounts increase, this amount will also increase so that it will equal two times the federal exemption amount.

In the typical estate plan, both the husband and wife would implement pourover wills and revocable trusts, and the joint assets would likely be transferred to the wife. The IRA, which cannot be transferred without income tax consequences, will be made payable to the surviving spouse with the husband's by-pass trust named as a contingent beneficiary in the event the surviving spouse disclaims the asset.

In a joint trust plan, the IRA would remain payable to the surviving spouse with the joint trust as the contingent beneficiary. The $1,500,000 in jointly owned assets would be transferred directly to the joint trust. In the event the husband dies first, his estate would be worth $3,000,000 with the $1,500,000 IRA flowing over to the surviving spouse eligible for the marital deduction and $1,500,000 allocated to the husband's by-pass trust. The surviving spouse would then be able to delay distributions until he or she attains age 70 and then take advantage of the new uniform life table stretching out the IRA benefits, to the extent permitted under the new IRA distribution Final Regulations.

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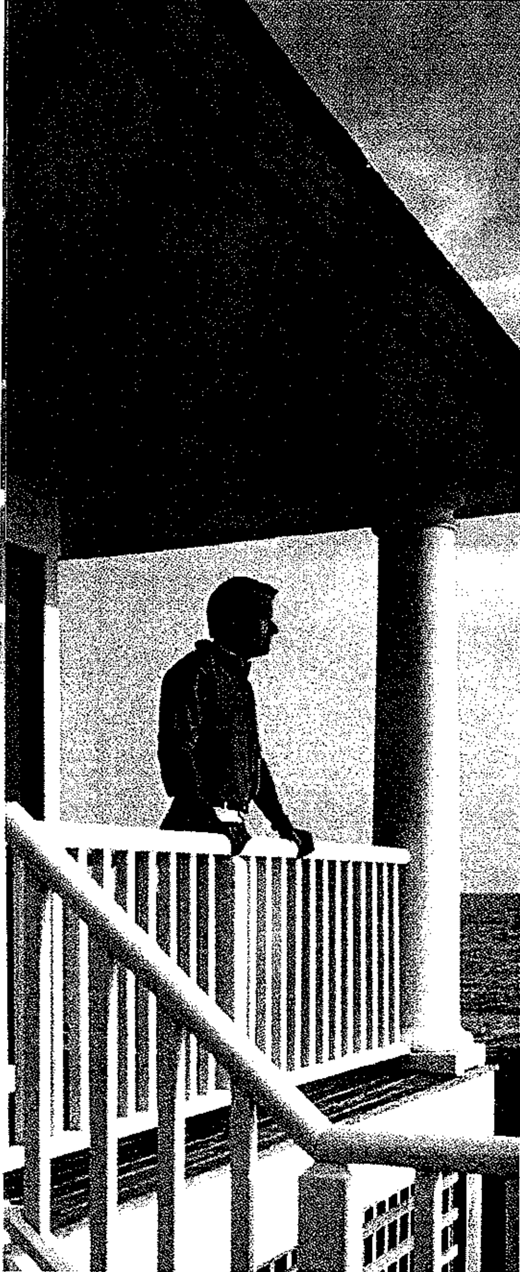


Joint Trusts Revolutionize Estate Planning for Retirement Assets & Estates Under $3 Million for Couples

Part II: Understanding the Operation of Joint Trusts in Planning Estates Under $3 Million and Estates with Large Qualified Plans in an Era of Rising Estate Tax Exemptions

By Leo J. Cushing, Esq., CPA, LLM
Melissa S. Conover, Esq.

Read the first part of this article online: [illegible]

In Part I, the challenges involved in planning estates under $3 million (or that amount equal to two times the federal estate tax exemption amount) and those with large qualified plans were outlined and the benefit of utilizing joint trusts discussed. This Part II provides a detailed discussion of how the joint trust works to achieve a desirable result and overcome the challenges outlined in Part I.

Here is how the technique works. Both the husband and wife become donors as well as co-trustees of a single joint trust. In both cases, the couple's non-retirement assets will be contributed to the joint trust directly with the IRA remaining payable to the surviving spouse. Upon the first death of a spouse, the assets contributed by the deceased spouse are includible in the decedent's estate under IRC § 2038 by virtue of a power of revocation contained in the instrument. As to those assets which were contributed and/or become payable to the trust by the surviving donor's spouse, such assets would also be includible in the estate of the first spouse to die under IRC § 2041 by virtue of a testamentary general power of appointment given to the deceased spouse by the surviving spouse.

While joint trusts have been used for many years, particularly in jurisdictions governed by community property rules, there were, prior to the IRS Private Letter Rulings 200101021 and 200210051, several unanswered questions. Specifically, in a joint trust, when was the gift from the surviving donor's spouse to the deceased spouse complete and would it be complete for the marital deduction? Second, if, and to the extent assets contributed to the joint trust by the surviving donor, were allocated to the by-pass trust, would the assets in the by-pass trust be includible in the estate of the surviving spouse under IRC § 2036?

The IRS answered all of these questions favorably to the taxpayer. A closer look at the facts in the Private Letter Rulings 200101021 and 200210051 show the details of the technique. In PLR 200101021, the trust provided that Grantor A and Grantor B were husband and wife and proposed to create a joint trust. Grantor A was the initial trustee of the trust and the grantors proposed to fund the trust with assets that they owned as tenants by the entirety. During the joint lives of the grantors, the trustee was permitted to apply income and principal of the trust as the trustee deemed advisable for the

comfort, support, maintenance, health and general welfare of the grantors. The trustee also could pay additional sums to either or both of the grantors, or to a third party for the benefit of either or both grantors as Grantor A directed or, if not capable of making such a decision, then as Grantor B directed.

While both grantors were living, either grantor could terminate the trust by written notice to the other grantor and, if terminated, the trustee was directed to deliver the trust property to the grantors in both their names as tenants in common. Either grantor could amend the trust while both grantors were living by delivering the amendment in writing to the other grantor at least 90 days before the effective date of the amendment.

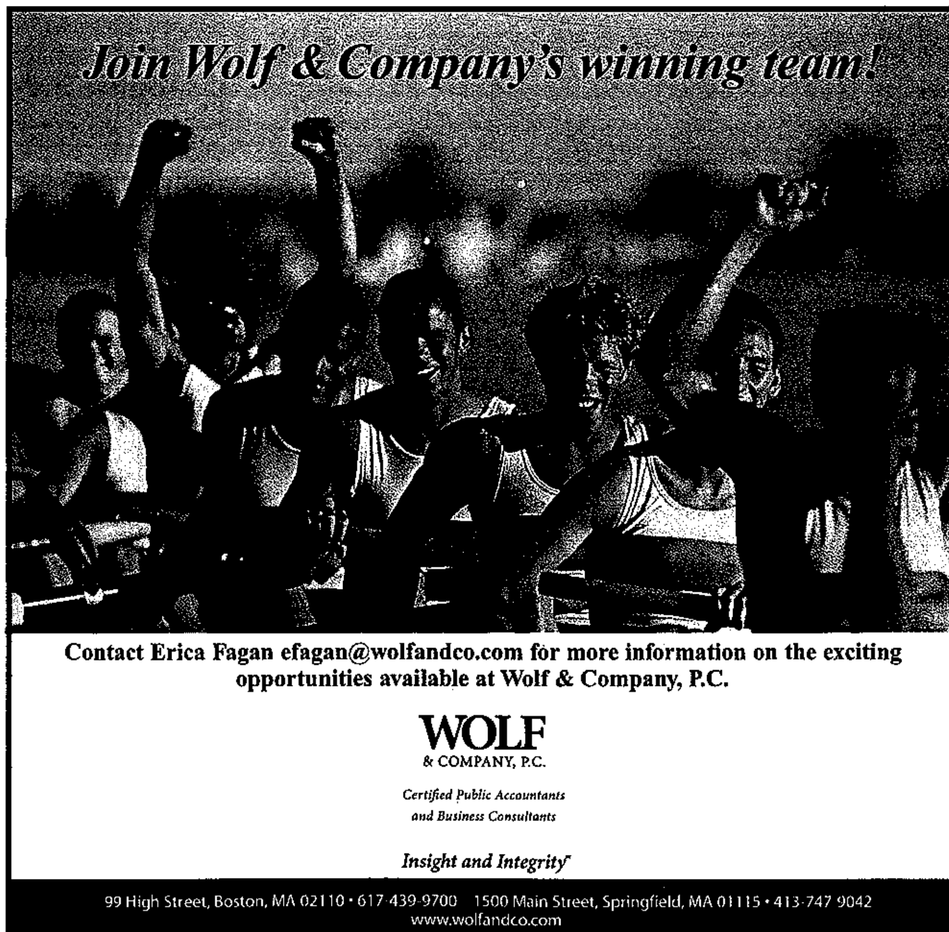
Upon the death of the first grantor to die, he or she possessed a testamentary general power of appointment exercisable alone and, in all events, to appoint part or all of the trust assets, including the assets contributed by the surviving spouse, free of trust to such deceased grantor's estate, or to or for the benefit of one or more entities in such proportions, outright, in trust, or otherwise, as the deceased grantor may direct in his or her will. In the event the first grantor to die fails to exercise his or her testamentary general power of appointment, and providing the surviving grantor survives the first grantor to die by at least six months, an amount of trust property sufficient to equal the largest amount that can pass free of federal estate taxes by way of the unified credit, was to be transferred to the credit shelter trust with the excess of such amount needed to fund the credit shelter trust that has not been appointed, passing directly to the surviving grantor.

In PLR 200210051, the husband and wife established a joint trust and funded it with assets that they owned jointly. The trust was funded with the assets that the donors owned as joint tenants with rights of survivorship or other assets which they owned in their individual capacity. The trust could be altered or amended by either donor with the consent of the trustees while both husband and wife were living. The trust also provided that, during the joint lives of the husband and wife, the trust could be revoked by either of the donors in whole or in part and, upon revocation, the trustee must, if so directed, transfer and convey in accordance with the direction of the donors, any or all of the trust property then held. Upon the death of either the husband or the wife, the trust became irrevocable.

Upon the death of the first donor to die, the trust provided that an amount of the trust property equal to the maximum marital deduction allowable to the deceased spouse's gross estate, reduced by the amount necessary to create the largest taxable estate, which, after utilizing the unified credit, will result in no tax due, is to be transferred to a marital trust. During the life of the surviving spouse, the trustee is directed to pay the net income to the surviving spouse at least quarter annual in such amounts of principal as the surviving spouse may direct. Upon the death of the surviving spouse, the trustee shall pay over any remaining principal to such persons that the surviving spouse shall appoint by his or her last will.

As to the remaining trust assets, these were to be held in a family trust. The family trust provided that during the life of the surviving spouse, the trustee is to pay all the net income to the surviving spouse. The trustee may also pay so much of the principal allocated to the family trust to or for the benefit of the surviving spouse and the issue of both donors as the trustee shall deem advisable for their health, support, maintenance or education. Upon the death of the surviving spouse, the remaining income and principal in the family trust shall be distributed to the donor's living issue, per stirpes.

As to the trusteeship, the trust provided that the husband and wife would act as co-trustees during their joint lives fol-



lowed with the surviving spouse serving alone, and, upon the death of the surviving spouse, the living children of the donor jointly, or the survivor of such children, would serve as trustees. In drafting joint trusts, it is important to either include a disinterested trustee or to allow the spouse to name a disinterested trustee to make non-support distributions to the spouse of principal to take advantage of a step up in basis upon the death of the surviving spouse. Finally, if no trustees were then serving, a trustee would be elected by majority of the beneficiaries and additional or successor trustees may be appointed by the trustees then serving.

The questions presented in each of the rulings were essentially the same.

(1) At what point in time was there a "completed gift" of the assets in the joint trust from one spouse to the other?

(2) Will the value of the entire trust assets be includible in the gross estate of the first grantor to die?

(3) On the death of the first deceasing grantor, will the surviving grantor be treated as making a gift that qualifies for the marital deduction to the deceased grantor, with respect to the portion of the trust property that is attributable to the surviving grantor's contributions to the trust?

(4) To the extent that assets contributed by the original grantor are used to fund the credit shelter trust, will those assets be considered contributed by such grantor? and finally,

(5) Will payments from the credit shelter trust to beneficiaries, other than the surviving grantor, constitute a gift from the surviving grantor to those beneficiaries and will any of the assets in the credit shelter trust be includible in the estate of the surviving grantor?

In each ruling, the IRS ruled that the initial contribution of assets to the joint trust will not constitute a completed gift by either grantor under Regulation 25.2511-2(c), since each will retain the right, exercisable unilaterally, to revoke their respective transfer and re-vest title in themselves.

In both PLR 200210051 and 200101021, the IRS ruled that the surviving grantor will have made a completed gift to the deceased grantor on the death of the deceased grantor under IRC § 2501 and the gift will be eligible for the marital deduction under IRC § 2523. The IRS ruled that, upon the death of the first grantor to die, the trust property attributable to the deceased grantor transferred to the trust will be includible in the deceased grantor's gross estate under IRC § 2038 and the balance of the trust property to the property contributed by the surviving grantor will be includible in the deceased grantor's estate under IRC § 2041 by virtue of the power of appointment.

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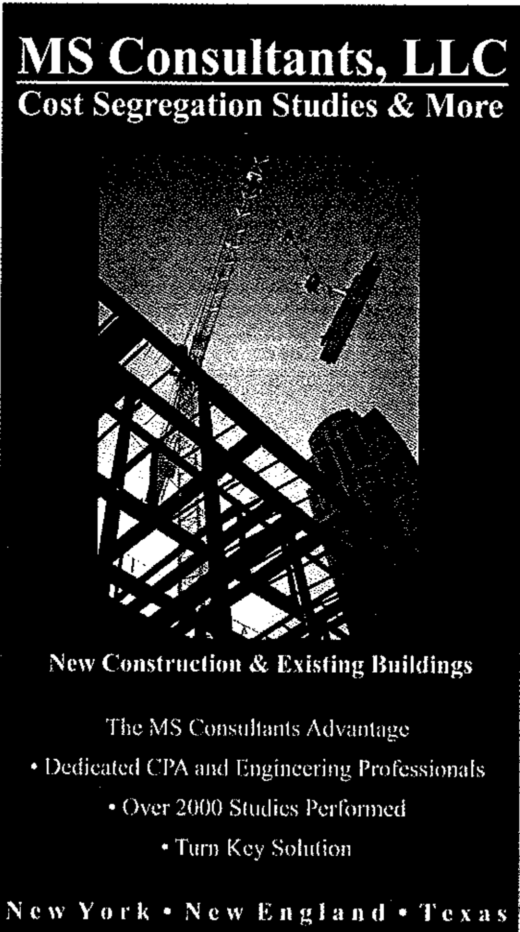

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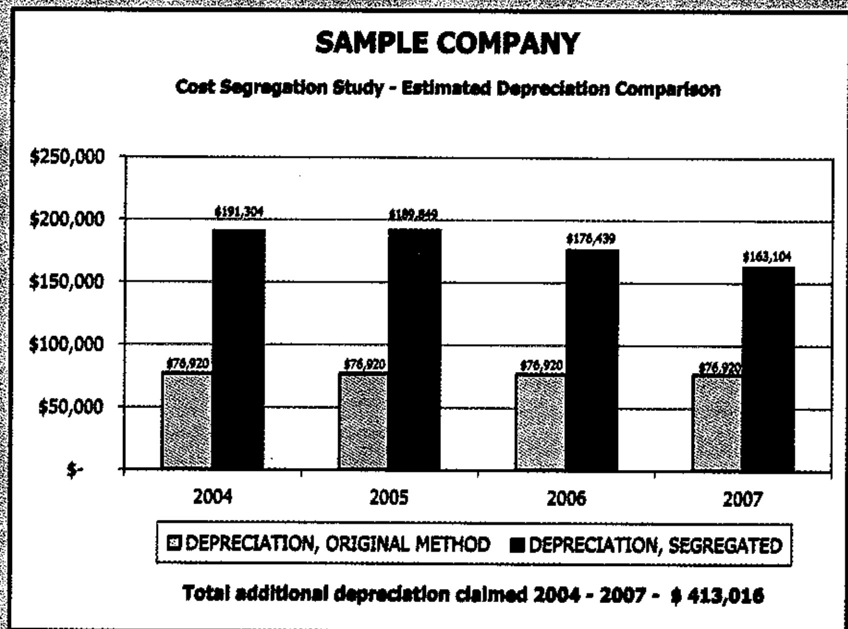

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Joint Trusts Revolutionize Estate Planning

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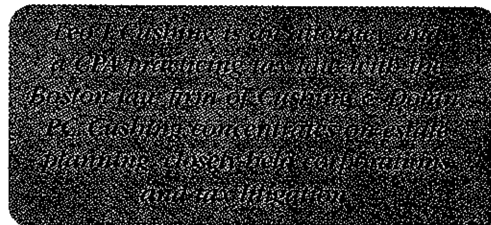
Finally, to the extent the credit shelter trust is funded, the property funding the credit shelter trust will be treated as passing to the trust from the deceased grantor and not from the surviving grantor so that the surviving grantor will not be deemed to have transferred property to a trust in which the surviving grantor is a beneficiary. As a result, the property allocated to the credit shelter trust will not be included in the estate of the surviving spouse under IRC § 2036.

It should be noted that the ruling sought advice as to whether all of the joint assets contributed by the couple would receive a step-up in basis under IRC § 1014(e). The IRS ruled unfavorably for the taxpayer in ruling that only those assets which were contributed by the decedent's spouse would be eligible for a step-up in basis relying upon IRC § 1014, which provides an exception to the general step-up rules of IRC § 1014(a).

Under IRC § 1014(e), if appreciated property was acquired by gift during the one year period ending on the date of the decedent's death, and the property is acquired from the decedent by, or passes from the decedent to, the donor of such property, the basis of such property in the hands of the donor is the adjusted basis of the property in the hands of the decedent immediately before the death of the decedent.

The ruling of the IRS in this regard is questionable. Since, in reality, the exception of IRC § 1014(e) should not apply to any property that was includible by virtue of the testamentary general power of appointment in which is paid over to the by-pass trust since this property did not "pass from the decedent to the donor" of such property.

This battle, however, can wait for another day since the question about the step-up in basis need not be resolved until the death of one of the spouses.



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Understanding Interpretation 101-3 Independence and Nonattest Services

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attest clients, such as valuations, appraisals, actuarial work and information systems design and implementation.

The revised Interpretation also incorporates an explicit requirement under Rule 101– *Independence,* that members must comply with more restrictive independence rules of other bodies - such as the state accountancy boards, the SEC, and the GAO - where applicable.

Previously, failures to comply with the independence requirements of these bodies had not been enforced under Rule 101, but rather were enforced under Rule 501 – *Acts Discreditable* of the Code.

Further Guidance and Clarification

The AICPA has dedicated an entire section of its Web site to providing background information and additional guidance on Interpretation 101-3. You can access this special section at:

www.aicpa.org/members/div/ethics/intr_101-3.htm

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