Estate Planning Section, Utah State Bar
Prepared by Fred D. Essig
Attorney at Law
Dixon & Essig, P.C.
(801) 538-2700
May 11, 2004

JOINT V. SEPARATE REVOCABLE TRUSTS FOR SPOUSES

A. BACKGROUND

Revocable trusts for husbands and wives can be structured as a single joint trust for both spouses or as a separate trust for each spouse. This handout compares many of the advantages and disadvantages of each approach. It then makes some generalizations of when each type of trust might be appropriate.

Joint revocable trusts may be classed into two primary types: Those that give each spouse a fractional interest in the whole trust and those that preserve the ownership of each spouse in the assets that spouse transferred to the trust by "tracing" these assets. This handout will discuss both types.

Nearly all practitioners create separate revocable trusts by using a separate document for each trust. The author, however, often writes a single document through which each spouse creates their own separate but virtually identical revocable trust. This latter approach has proved useful when the provisions of each trust are nearly identical. Both approaches are contrasted below.

There are many variations on the arrangements described above that are occasionally used by practitioners. These variations will affect the advantages and disadvantages below. It is not possible to discuss many variations in this handout.

B. COMPARISON CHART

A chart comparing many of the advantages and disadvantages of joint trusts (fractional and asset tracing) and separate trusts (created in separate documents or the same document) follows:

ADVANTAGES OF JOINT TRUST OVER SEPARATE TRUSTS

ATTRIBUTE	JOINT TRUST WITH FRACTIONAL SHARES	JOINT TRUST WITH ASSET TRACING	SEPARATE TRUSTS IN SEPARATE DOCUMENTS	SEPARATE TRUSTS IN ONE DOCUMENT
1. BASIS STEP-UP, COMMUNITY PROPERTY. Preserves step-up in tax basis on both spouses' community property assets on death of first spouse if trust satisfies State law requirements.	YES, if 50% share.	YES	NO, though some community property States may allow it.	NO, though some community property States may allow it.
2. BASIS STEP-UP, ALL ASSETS. Allows a stepped-up basis on both spouses' assets in the trust(s) on the first spouse's death even though no community property is involved if the first spouse to die is given a testamentary general power of appointment over all trust assets. <u>However, the IRS will disallow such basis step-ups if the assets return to the surviving spouse at death</u>, Priv. Lts. Rul. 93-08-002(Nov. 16, 1992), <u>or to a trust for the surviving spouse</u>, See Priv. Ltr. Rul. 90-26-036(March 28, 1990). Also, the granting of this general power will allow creditors of the first spouse to die to reach trust assets of both spouses at death, not just the deceased spouse's assets. Joint or separate trusts may also enable assets of a surviving spouse to be sheltered from estate taxes on the death of the first spouse. <u>See</u>, <u>e.g.</u>, Priv. Ltr. Rul. 200403094.	YES, probably.	YES, probably.	YES, probably. If this works with a joint trust, it should work with a separate trust.	YES, probably. If this works with a joint trust, it should work with a separate trust.
* 3. SAVES ATTORNEY TIME & COSTS. Less time is required for an attorney to draft, review, sign & amend trust, so expenses are lower. Client has less to read also.	YES No, MUCH MORE COMPLEX LANGUAGE TO BE DRAFTED (SEE 25)	YES	NO	YES
4. TRANSFERS LESS CONFUSING. Transfers to the trustee are less confusing to the client because there is only one trust to remember and name.	YES	YES, unless you must make prior transfers to balance values in estates exposed to estate taxes	NO	NO
5. ASSETS ARE "SHARED" BY SPOUSES. Spouses who feel that all their assets are shared by both spouses are more satisfied because their assets do not appear to be divided.	YES	YES	NO	NO
6. FEWER TRANSFERS AND COSTS ON FIRST DEATH. If estates are not exposed to estate taxes, trust reduces asset transfers and costs upon the death of the first spouse if all assets remain in the revocable trust.	YES	YES	NO, usually.	NO, usually.
7. NO INCOME TAX RETURN REQUIRED. If estates are not exposed to estate taxes, there may be no need to file income tax returns for the trust in the year the first spouse dies if all assets remain in the trust and the trust remains revocable by the surviving spouse.	YES	YES	NO, usually.	NO, usually.
8. ASSETS NOT ALLOWING TWO TRUST OWNERS. Trust allows an asset's ownership to be divided in trust between spouses when a financial institution will not allow two trusts to own an asset.	YES	YES	NO	NO

FRAUD
SECOND MARRIAGES
ASSET PROTECTION
CREDITOR PROTECTION

ADVANTAGE OF JOINT TRUST WITH FRACTIONAL SHARES OVER OTHER TRUSTS

ATTRIBUTE	JOINT TRUST WITH FRACTIONAL SHARES	JOINT TRUST WITH ASSET TRACING	SEPARATE TRUSTS IN SEPARATE DOCUMENTS	SEPARATE TRUSTS IN ONE DOCUMENT
9. EASIER TO PRESERVE ASSET BALANCE WITHIN THE TRUST. In estate exposed to estate taxes, trust automatically preserves the balance of ownership values of trust assets between spouses as the values of the trust assets change without having to name two trusts as the owner of each asset or divide up identical assets.	YES, but does not preserve balance of assets outside trust (e.g., retirement benefits, life insurance, etc.)	NO	NO	NO

DISADVANTAGES OF JOINT TRUST WITH FRACTIONAL SHARES OVER OTHER TRUSTS

ATTRIBUTE	JOINT TRUST WITH FRACTIONAL SHARES	JOINT TRUST WITH ASSET TRACING	SEPARATE TRUSTS IN SEPARATE DOCUMENTS	SEPARATE TRUSTS IN ONE DOCUMENT
10. EACH SPOUSE RETAINS OWNERSHIP AND CONTROL OVER DESIRED ASSETS THROUGH THE TRUST. Allows each spouse to retain full ownership and control of the assets they desire to own and control while still funding the revocable trust. Examples of such assets include inheritances and closely held family businesses.	NO	YES, if the tracing succeeds.	YES	YES
11. SPOUSE UNLIKELY TO MISTAKENLY GIVE OWNERSHIP AND CONTROL TO OTHER SPOUSE. One spouse is unlikely to mistakenly gift ownership and control of their asset to the other spouse because of confusion over the fraction of the asset they own and control before & after the transfer.	NO	YES	YES	YES
12. EASIER TO ADJUST ASSET BALANCE OVER BOTH ESTATES. In estates exposed to estate taxes, or potential fraud or remarriage or second marriage problems trust allows easy adjustment of balance of assets between spouses through transfers of one or more specific assets. These transfers enable each spouse to maximize the use of their unified credit and GST exemption without having to revalue all assets and amend the trust's percentage share of each spouse. This balancing recognizes that valuable assets may be owned by just one spouse outside the trust. Common examples include retirement benefits, life insurance, and closely held family businesses.	NO	YES, but may require transfer from trust to spouses, to spouse, then to trust.	YES	YES
13. MINIMIZES CONTAMINATED PROPERTY LIABILITY. Minimizes exposure to liability for cleaning up contaminated property since there may be fewer owners or operators of the property.	NO	YES, probably.	YES	YES
14. LESS COST TO VALUE ASSETS. Less time and cost required to value assets for planning or creditor claims before death of first spouse and for tax reporting upon death of first spouse. This is because only the assets of one spouse that are in trust require valuation, not the assets of both.	NO	YES	YES	YES

ADVANTAGE OF JOINT TRUST WITH ASSET TRACING OVER OTHER TRUSTS				
ATTRIBUTE	JOINT TRUST WITH FRACTIONAL SHARES	JOINT TRUST WITH ASSET TRACING	SEPARATE TRUSTS IN SEPARATE DOCUMENTS	SEPARATE TRUSTS IN ONE DOCUMENT
15. PREVENTS GIFTS OR ESTATE TAXES FROM CROSS TRANSFERS WITHOUT MARITAL DEDUCTION. Minimizes risk of gift tax consequences resulting from a transfer from one spouse to the other spouse's revocable trust that does not qualify for the marital deduction. These transfers must be reported to the IRS on Form 706, Schedule G, whether or not the marital deduction is allowed. This tax exposure can be eliminated by drafting the revocable trust to qualify for the marital deduction. Failure to qualify could cause some assets to be subjected to estate taxes twice in the same estate.	NO	YES	No (more $ risk but less likely than with fractional share trust)	NO (more $ risk but less likely than with fractional share trust)

DISADVANTAGES OF JOINT TRUST WITH ASSET TRACING OVER OTHER TRUSTS				
ATTRIBUTE	JOINT TRUST WITH FRACTIONAL SHARES	JOINT TRUST WITH ASSET TRACING	SEPARATE TRUSTS IN SEPARATE DOCUMENTS	SEPARATE TRUSTS IN ONE DOCUMENT
16. EASY TO TELL TRUST OWNERSHIP DURING BOTH SPOUSES' LIVES. Little time or cost required to tell balance of ownership of trust assets between spouses for transfer tax planning during both spouses' lives. During both spouses' lives, little risk of litigation with creditors, upon divorce, or with IRS over the filing of separate income tax returns, all resulting from inability to show how much of the trust each spouse owns.	YES	NO. Can be a major problem requiring tracing of contri-butions, sales & purchases, income, expense payments & distributions.	YES	YES
17.EASY TO TELL TRUST OWNERSHIP WHEN THE FIRST SPOUSE DIES. Little time or cost required to tell balance of ownership of trust assets between spouses for reporting on estate and inheritance tax returns when the first spouse dies. Upon the first spouse's death, little risk of litigation with creditors, IRS, family members in a second marriage, or beneficiaries of the spouses' different estate plans, over which spouse owned the trust assets.	YES	NO. Can be a major problem requiring tracing of contri-butions, sales & purchases, income, expense payments & distributions	YES	YES
18. MINIMIZES RISK OF FAMILY TRUST BEING SUBJECTED TO ESTATE TAXES. Upon the surviving spouse's death, creates little risk that IRS will subject all or part of the Family/Credit Shelter/B Trust to estate taxes under I.R.C. Sec. 2036 or 2038 by asserting that some assets were transferred there from the surviving spouse. This could result from inability to trace assets or inadequate language defining which assets pass to which trust on the first death (e.g., life insurance, retirement, etc.).	YES	NO	YES	YES
19. REDUCES TRUSTEE'S EXPOSURE FOR DISTRIBUTIONS TO WRONG BENEFICIARY. Minimizes risk of trustee's liability for distributing trust assets to the wrong spouse or other beneficiary in violation of the trust because asset ownership is unclear.	YES, if distributed fractionally.	NO	YES	YES

ADVANTAGES OF SEPARATE TRUSTS OVER JOINT TRUST				
ATTRIBUTE	JOINT TRUST WITH FRACTIONAL SHARES	JOINT TRUST WITH ASSET TRACING	SEPARATE TRUSTS IN SEPARATE DOCUMENTS	SEPARATE TRUSTS IN ONE DOCUMENT
20. REDUCES ESTATE TAX EXPOSURE BY GRANTING EASY TO DRAFT POWERS OVER ASSETS TO EACH SPOUSE. If estates are exposed to estate taxes, trust minimizes the risk of estate taxes arising because less than the desired portion of the revocable trust is includible in the estate of the first spouse to die, which, in turn, causes a failure to fully use their unified credit. This may result from failure to properly write amendment or revocation powers or general powers of appointment of the first spouse to die.	NO	NO	YES	YES
21. LESS COST TO TRANSFER ASSETS. If estates are exposed to estate taxes, trust avoids the time and costs of transferring the surviving spouse's assets on the death of the first spouse.	NO, usually.	NO, usually.	YES	YES
22. MAY HOLD S CORPORATION STOCK 2 YEARS. Allows S corporation stock to be held by the trust for 2 years instead of just 60 days upon the death of the first spouse (I.R.C. Sec. 1361(c)(2)(A)(ii)) and Treas. Reg. Sec. 1.1361-1(h)(3)(i)(B) and (k)(Example 1)).	YES, probably but harder to write.	YES, probably but harder to write.	YES	YES
23. MAY PREVENT LOSS OF S CORPORATION STATUS. May prevent loss of S corporation status for stock owned by the trust because one spouse is not a U.S. citizen or resident. (Treas. Reg. Sec. 1.1361-1(h)(1)(i) and (3)(i)(A)).	NO	YES, probably	YES	YES
24. SAVES DRAFTING OF EXTRA TRUST. Eliminates the time loss, cost and complexity required to draft for the creation of an extra revocable trust on the death of the first spouse when a trust is to be created for remarriage protection of the assets of the first spouse to die.	NO	NO	YES	YES
25. SIMPLER TRUST LANGUAGE. Clients find the trust's language to be shorter and simpler in describing the rights of each spouse, how many trusts are being created, or how to divide the trust.	NO	NO	YES, but the clients have 2 trust documents to read instead of one.	NO
26. SEPARATE ASSET IDENTIFICATION. Spouses who prefer to keep 1 or more of their assets separately identified will be more satisfied with the trust.	NO	NO	YES	YES
27. DIFFERENT TRUSTEES. Spouses do not agree on whom should serve as current or future trustees of their assets.	NO	NO	YES	YES
28. DIFFERENT TRUST BENEFICIARIES OR BENEFITS. Spouses do not agree on whom the current or future trust beneficiaries should be or what their benefits should be.	NO	NO	YES	YES, if differences are not too extensive.

C. ONE APPROACH TO DECIDING WHICH TRUST TO USE

It is the author's belief that the question of which type of revocable trust to use between spouses should turn on the circumstances in which the clients are in. These circumstances should be applied to the most important attributes of each trust. Specifically, the following approach may prove useful in a common law State.

Note: The author's approach is to rarely use a fractional joint trust because of the forced release of ownership and control of assets that clients experience in a common law State. For a brief discussion of this problem, see attributes 10 and 11 in Part B, above. The author prefers to instead let the clients decide whether they want to release ownership and control of their assets to their spouse on an asset by asset basis.

1. If No Estate Tax Exposure. If a husband's and wife's estates are not exposed to estate taxes, a joint revocable trust could be presumed best. Attributes 1-8 in Part B, above, provide reasons for this presumption. Before using a joint trust, however, the attorney should consider whether any of the advantages described under "Separate Trust Advantages" on the next page overcome the joint trust presumption. If not, use a joint trust. If the "Separate Trust Advantages" overcome the presumption of a joint trust, consider whether the "Joint Trust Advantages" below outweigh the "Separate Trust Advantages."

what about fraud exposure?

2. If Estate Tax Exposure. If a husband's and wife's estates are exposed to estate taxes, separate revocable trusts could be presumed best. Attributes 10-12 , 16-18, and 20 in Part B, above, provide a basis for this presumption. Before using a separate trust, however, the attorney should consider whether any of the advantages summarized under "Joint Trust Advantages" below overcome the separate trust presumption. If not, use separate trusts. If the "Joint Trust Advantages" overcome the presumption of separate trusts, consider whether the "Separate Trust Advantages" on the next page outweigh the "Joint Trust Advantages."

In preparing the summary list of trust advantages below, the author has selected the attributes of each trust from Part B, above, that he considers most important. Other practitioners may differ with the author on the selection. Each item shown lists at the end in parentheses the number of the attribute in Part B to allow a review of the advantages of that type of trust in that situation.

JOINT TRUST ADVANTAGES

1. **Community property**. Substantial appreciated community property will be held in the trust that may be sold after the first spouse dies but before the second spouse dies. (1)

2. **Basis step-up**. Substantial appreciated common law property will be held in the trust that may be sold after the first spouse dies but before the second spouse dies that will not pass to or in trust for the surviving spouse & there is no significant exposure to creditors' claims. (2)

SEPARATE TRUST ADVANTAGES

A1. FRAUD -- POTENTIAL FRAUD EXPOSURE

1. **Creditor claims.** There are one or more substantial judgements, existing creditor's claims, or possible creditor's claims against one or both spouses. (16, 17)

2. **2nd or later marriage with children from prior marriage.** One or both spouses have children from a prior marriage. (16, 17)

3. **Unstable marriage.** You sense the clients' marriage is unstable and may end in divorce. (16)

4. **Spouses' estate plans differ.** The spouses' estate plans differ as to beneficiaries or benefits so that it will make a difference as to which spouse owns each asset in the trust when each spouse dies. (17, 28)

5. **One or more significant assets are deliberately owned by only one of the spouse's.** One spouse has deliberately retained sole ownership of one or more assets for any reason. (10, 11, 16, 17, 19)

6. **Contaminated property exposure.** There is significant exposure to liability for failing to clean up contaminated property. (13)

7. **Separate income tax returns.** The spouses' file separate income tax returns. (16)

8. **S Corporation stock.** One or both spouses own substantial S corporation stock. (22, 23)

9. **Estate tax drafting concerns.** There is estate tax exposure, and you are concerned about your ability to draft a joint trust that qualifies transfers during both spouses' lives for the marital deduction, that defines which assets pass to which trust on the first death, and that grants proper powers during both spouses' lives to fully fund the Family/Credit Shelter/B Trust. (15, 18, 20)

10. **Different trustees.** The spouses do not agree on whom should be current or future trustees of their assets. (27)

11. **Spouses are young.** The spouses are young and therefore have more time to encounter the items described above, including estate tax exposure, creditors' claims, remarriage, divorce, differing estate plans, desire to keep assets separate, contaminated property, separate tax returns, or S corporation stock.

SIMPLICITY VERSUS FRAUD PROTECTION
REMARRIAGE PROTECTION
PROTECTION OF SECOND MARRIAGE ADULT CHILDREN
CREDITOR PROTECTION
ASSET PROTECTION