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The Joint Trust in Oregon: A Square Peg in a Round Hole?

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Chapter 3

The Joint Trust in Oregon: A Square Peg in a Round Hole?

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I. OVERVIEW

In this presentation, the term "joint trust" refers to a revocable trust created by a married couple as the trustors. The spouses are the beneficiaries of the joint trust during their lifetimes and they make provisions for the surviving spouse or other beneficiaries following each of the spouses' deaths. Similar to a single trustor revocable trust, a joint trust is irrevocable at the second spouse's death. The joint trust may be at least partially irrevocable at the first spouse's death, depending on the terms of the trust agreement.

Our discussion and examples generally do not address the possibility that the spouses have altered their property rights by an enforceable marital agreement. Of course, any existing premarital or postmarital agreement must be taken into consideration when planning for clients.

A. The Appeal of a Joint Trust.

Joint trusts are an attractive concept to many married couples. Clients who move to Oregon from a community property state usually are familiar with the community property form of co-ownership of assets and may already have established a joint trust in that state. Even lifelong residents of Oregon will favor joint trusts in many cases. Married couples who already own most of their property jointly, with survivorship rights, often prefer to keep the appearance of the "joint" character of their assets when transferring them to a revocable trust for estate planning purposes. The primary alternative (separate, revocable trusts) requires dividing the ownership of joint accounts and other property and allocating specific assets to each spouse's separate trust. Many clients are uncomfortable with the concept of dividing up assets during their marriage and perceive a joint trust as a simple way to maintain the status quo ownership of their property, while planning to avoid probate at their deaths.

As we will see, the processes of drafting, funding, and administering joint trusts are more complicated than they may appear. There are complex tax considerations at play when using a joint trust for estate planning in a separate property state. Practitioners should understand these issues before advising clients on using a joint trust for estate planning purposes.

B. Community Property vs. Separate Property/Common Law Jurisdictions.

Joint trusts are fairly intuitive estate planning vehicles for married couples in community property states. Unless there is a specific marital agreement to the contrary (and with a few exceptions for inheritances, etc.), community property jurisdictions treat all property earned or accumulated during a marriage as the property of both spouses. Both spouses have equal ownership rights with respect to community property, regardless of how each item is titled. Thus, mixing and mingling a married couple's assets in a joint trust is consistent with the state law characterization of those assets as marital property, and generally does not pose thorny tax questions upon funding the joint trust or when a spouse dies.

In contrast, common law states like Oregon do not automatically treat property earned and accumulated during a marriage as jointly owned by both spouses. The way that property is titled generally controls the disposition of that property when a spouse dies. If each spouse owns property in his or her sole name, that property will pass according to his or her respective estate plan. The act of transferring separately-owned property to a joint trust can have property ownership and tax ramifications.

C. Tax Issues with Joint Trusts in a Separate Property State.

Several potential tax problems could arise when transferring assets to a joint trust or at the death of one of the spouses.

1. Depending on the terms of the trust agreement, a spouse who owns more than 50% of property before transferring that property to the joint trust could inadvertently make a taxable gift to the other spouse when funding the joint trust. See Section II.C.

2. Consideration must be made in drafting a joint trust agreement to avoid causing the surviving spouse to make completed gifts to the remainder beneficiaries upon the death of the first spouse. See Section III.D.

3. Take care to avoid the unintentional inclusion of Credit Shelter Trust assets in the gross estate of the surviving spouse. See Section III.E.

4. Be aware that the provisions of the trust agreement can affect the income tax basis adjustments occurring at both the death of the first spouse and the death of the surviving spouse. See Sections III.C. and IV.C.

D. When are Joint Trusts Appropriate?

Putting tax concerns aside, joint trusts are not appropriate for every married couple. The following factors are indications that a joint trust may be a reasonable option for married clients:

1. The clients have moved to Oregon from a community property state, and

    a) Already established and funded a joint trust in the community property state; and/or

    b) Wish to maintain the community property status of their assets under Oregon's quasi-community property laws.[1]

2. Most or all of the clients' assets are already jointly titled, and they prefer not to divide the ownership of the assets between separate revocable trusts.

3. The clients' estate plans are aligned, with

    a) Substantially similar preferences for the surviving spouse's rights, responsibilities, and access to trust assets after the first death, regardless of which spouse survives; and

[1] *See* the Oregon Uniform Disposition of Community Property Rights at Death Act, ORS 112.705 to 112.775.

b) Substantially similar remainder beneficiaries. This is likely to be the case in many "first marriage" situations.

E. Meet the Flanders Family.

We will refer to the Flanders family throughout this presentation. Ned and Maude Flanders[2] are our hypothetical estate planning clients. Ned, Maude, and their children Rod and Todd are lifelong residents of Oregon. Ned and Maude were high school sweethearts, and this is their first and only marriage.

The Flanders' assets are described on the "Asset List" included as Exhibit A. This asset profile puts the Flanders family squarely in the territory of "Oregon taxable" estates, but well under the federal estate tax exemption amount.[3]

Ned and Maude have heard horror stories about probate and want to avoid it at all costs… except perhaps at the cost of dividing up their assets and contributing them to separate revocable trusts. They are more comfortable with the concept of a joint trust, since much of their property is titled jointly and they consider most assets to be "theirs" rather than "his and hers." Ned and Maude are willing to go through the process of re-titling most assets to a joint trust, but they urge you to "keep it simple."

F. Terms Used in This Presentation.

We all have our own drafting lingo. We endeavor to be consistent with our terms in this outline. Here is a quick list of what we mean when we say…

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[2] THE SIMPSONS characters, names, and other indicia are the intellectual property of Twentieth Century Fox Film Corporation.

[3] For now. Under current law, each person's estate is taxable for Oregon purposes if the gross estate exceeds $1,000,000 in value. ORS 118.010. The federal estate tax exemption for 2020 is $11.58 million per individual. This exemption amount is set to expire on December 31, 2025, at which time the exemption amount will return to $5,000,000, adjusted annually for inflation. IRC §2010. The "portability" feature of federal law allows the unused federal exemption of the first spouse to die to be used by the surviving spouse. IRC §2010(c)(4). However, as we have seen over the years, the federal estate tax exemption amount is a bit of a political football and is subject to the whims of Congress.

1. *Trustors*: grantors, settlors, trustmakers -- the person(s) creating the trust.

2. *Credit Shelter Trust*: An irrevocable trust funded on the death of the first spouse that is intended not to be included in the surviving spouse's estate for estate tax purposes. Often, this type of trust uses the state or federal estate tax exemption of the first spouse to die.

3. *Decedent Fund*: the portion of the joint trust property that belongs to the first spouse to die.

4. *Survivor Fund*: the portion of the joint trust property that belongs to the surviving spouse.

5. *Joint Fund*: Property held by the joint trust that is deemed by the terms of the trust agreement to be owned by both spouses in equal shares. That is, the portion of the trust assets that does not include separate property that is designated as belonging only to one spouse.

II. THE JOINT TRUST DURING LIFE: FUNDING AND ADMINISTRATION

A. The Setup.

1. Property that spouses contribute to a joint trust will come from one of two categories. The first category is property that spouses own equally (such as, as tenants by the entirety, joint tenants or tenants in common). The second category is property that spouses own disproportionately (or "un-equally"), such as property in the name of one spouse.

    a) When spouses contribute equally owned property to the joint trust, there is not a transfer of ownership for transfer tax purposes.

        (1) Example: Ned and Maude contribute two assets to the Flanders Family Trust: real estate owned as tenants by the entirety and a

brokerage account owned as joint tenants with right of survivorship.

(2) Assuming a properly drafted trust agreement, there is no change in the proportional ownership of the property and no tax concerns. The transfer is merely a change in title to facilitate estate planning. PLR 20-0101021.

b) Gift tax concerns arise when spouses make un-equal contributions of property to a joint trust, with the intent to make such property equally owned once it becomes part of the joint trust.[4]

(1) Example: Ned has a $1,000,000 brokerage account in his individual name. Ned and Maude always intended this would be a joint account, but they just haven't gotten around to retitling it. Ned plans to put it in the joint trust, and wants it to be a joint asset.

(2) Issue: The transfer of un-equal property is a gift in trust from the transferor spouse (Ned) to the transferee spouse (Maude). In order to avoid adverse gift tax consequences, the transfer of 50% of the account in trust for Maude must qualify for the marital gift tax deduction.

B. The Trust Fund: Joint Fund, Separate Shares, or Both.

1. Joint Fund. At first glance, holding the trust assets a single, common "joint fund" seems to make sense. After all, the joint trust is likely to appeal to couples that do and intend to continue to share the assets equally (or at least equitably).

a) The "joint fund" should be defined in the trust agreement to establish that each trustor has an

[4] Equalization of ownership can be important for estate tax planning purposes, both to maximize the property available to fund a Credit Shelter Trust at the first spouse's death, and to avoid inclusion of Credit Shelter Trust assets in the surviving spouse's estate, as discussed in Section III.E.

undivided 50% interest in each asset contributed to the trust, unless the contribution is designated as the separate property of one trustor.

(1) This definition makes it clear that either spouse's trust property can be identified at any time -- including when a spouse exercises their power to revoke trust property or on the death of the first spouse.

(2) The trust agreement should provide that any distribution from the joint fund is deemed to be made to both spouses in equal shares. This maintains the equality in the joint fund.

b) Potential pitfalls of the joint fund approach arise when *property that spouses do not own equally* is contributed to the trust and made part of the joint fund.

(1) If the transfer from single to joint ownership does not qualify for the marital deduction, funding the joint trust could result in taxable gifts between spouses! See the following Section II.C.

(2) A joint fund may create ambiguity as to the ownership of property on the death of the first spouse. This risks the Credit Shelter Trust being funded with property deemed to have been contributed by the surviving spouse, and causing inclusion of Credit Shelter Trust assets in the surviving spouse's gross estate under IRC §2036. See Section III.E.

c) The potential for divorce should also be considered in the planning phase for a joint trust. If a joint fund is used, each spouse has an undivided interest in one-half of the trust property.

(1) If a spouse is contributing separate property to a joint trust, it is important that they understand this changes the nature of the ownership and that it exposes the property to equitable distribution in a divorce.

(2) Again, if one or both spouses have significant separate assets or a complex pre-marital agreement a joint trust may not be the best estate planning tool for them.

2. <u>Separate Shares</u>. Separate shares seem to solve the gift tax and property ownership on divorce issues raised by a joint fund. This theory means that each spouse holds their contributions to the joint trust in separate shares, with a retained right to withdraw his or her entire separate share.

   a) The retained right of withdrawal ensures there is no completed gift from a spouse until the contributing spouse dies.

   b) Using only separate shares is the functional equivalent of two separate revocable trusts, and defeats much of the purpose of holding assets in a joint trust for convenience.

   c) Meticulous record-keeping is necessary with this approach.

3. <u>Hybrid Approach: Joint Fund and Separate Shares</u>. For many couples, including Ned and Maude Flanders, a mixture of the joint fund and separate shares approach is appropriate.

   a) The spouses can contribute their joint assets to the joint fund, where each owns an undivided 50% interest in each asset.

   b) In addition, the joint trust agreement provides that either spouse may hold property in their separate trust share, and that property will belong 100% to the contributing spouse. Spouses will need to understand that any separate property must be segregated from the joint fund. This is done by titling the asset as separate property (see Section II.D.) and not unintentionally commingling separate and joint property.

C. Avoiding Taxable Gifts to a Spouse when Funding a Joint Trust.

1. Taxable gifts between spouses on funding a joint trust are only a risk when spouses contribute property they do not own equally to the joint fund. We assume that the terms of the trust agreement create 50/50 ownership over the joint fund, therefore, a gift arises when a spouse that owns more than a 50% interest in property contributes that property to the joint fund. As discussed in Section II.C.5, below, one option is to transfer all property to joint ownership prior to funding the joint trust.

2. There are two methods for avoiding a taxable gift when un-equal property is contributed to a joint trust: make the transfer an incomplete gift or qualify the transfer for the gift tax marital deduction.

3. <u>Incomplete Gifts</u>. Ensuring that un-equal transfers are incomplete gifts by giving each spouse a unilateral right to withdraw their transfers is not a workable solution. Record keeping will be required. Moreover, if each spouse prefers to retain unilateral control over their property, a joint trust is probably not the right estate planning tool.

4. <u>Marital Deduction Gifts</u>. Qualifying the transfer of un-equal property to the joint fund for the gift tax marital deduction is achieved by drafting a trust agreement where such transfers qualify for the marital deduction under IRC §2523(e) as a gift of a life estate with a general power of appointment. IRC §2523(e) and Treas. Reg. §25.2523(e)-1.

   a) In order to qualify as an IRC §2523(e) “power of appointment trust”, the transferee spouse’s interest in the trust must include the following five conditions. That is, the terms of the joint trust agreement must create the following rights and powers in the transferee spouse. Treas. Reg. §25.2523(e)-1(a).

(1) The transferee spouse must be entitled to all income from their portion of the joint trust assets. Treas. Reg. §25.2523(e)-1(a)(1).

(a) The “all income” requirement is satisfied if the spouse has the power to direct the trustee to distribute the trust corpus (including accumulated income) during their lifetime. Treas. Reg. § 25.2523(e)-1(f)(6).

(2) The income must be payable at least annually. Treas. Reg. §25.2523(e)-1(a)(2). See above regarding satisfying the all income requirement.

(3) The transferee spouse must have the power to appoint their portion of the joint trust assets to him or herself or to his or her estate (a general power of appointment). Treas. Reg. §25.2523(e)-1(a)(3).

(4) The general power of appointment held by the transferee spouse must be exercised by such spouse alone and in all events. Treas. Reg. §25.2523(e)-1(a)(4). Requirements (3) and (4) are met only if the spouse’s power of appointment falls within one of the following categories:

(a) The spouse has the power to appoint property in the spouse’s favor during life. Treas. Reg. §25.2523(e)-1(g)(1)(i).

(b) The spouse has the power to appoint the spouse’s portion of the joint trust assets to the spouse's own estate. Treas. Reg. §25.2523(e)-1(g)(1)(ii).

(c) Throughout the term of the trust, the spouse has some combination of the powers described in (a) and (b). Treas. Reg. §25.2523(e)-1(g)(1)(ii).

(d) If the transferee spouse has the requisite general power of appointment, they may also have "lesser" powers, such as the power to direct the trustee distribute the spouse's share of the joint trust assets to the other spouse or a limited testamentary power of appointment. Treas. Reg. § 25.2523(e)-1(g)(5).

(e) The trust agreement *should not restrict the spouse's general power of appointment in the event of incapacity*. The existence of the power matters for purposes of determining the tax consequences, not the ability to exercise it. Rev. Rul. 55-518.

(5) The spouse's portion of the joint trust property must not be subject to a power held by any other person to appoint property to anyone other than the transferee spouse. Treas. Reg. §25.2523(e)-1(a)(5).

(a) So long as the transferee spouse is serving as trustee and may act unilaterally as to such spouse's share of the joint trust property, the transferee spouse may direct distributions to any person.

(b) If any person other than the transferee spouse is serving as trustee, distributions should be limited to the transferee spouse. The only exception is transfers to the transferee spouse's minor children that the spouse has a legal obligation to support. Treas. Reg. §25.2523(e)-1(h).

(c) Consider: it is not uncommon to authorize the trustee or the spouse's agent to make gifts of the transferee spouse's portion of the joint trust property to beneficiaries of the spouse's estate plan. This is good planning to provide flexibility for reducing the size of the estate for Oregon estate tax purposes. However, it seems to violate condition (5), thereby risking qualification for the gift tax marital deduction.

5. An alternative to drafting a trust agreement to qualify for the marital deduction (or to relying on any such provisions in the trust agreement) is to re-title any un-equal assets as joint property prior to contribution to the joint trust. For example, real estate held by Ned may be re-titled (by signing and recording a deed) to Ned and Maude, tenants by the entirety. In turn, Ned and Maude transfer the property (by signing and recording another deed) to the trustees of the Flanders Family Joint Trust.

    a) The transfer of property to the joint trust is a transfer of equally owned property, so there is no concern of an un-equal transfer (i.e., a taxable gift).

    b) The down side of this process is the additional time and expense. Whether this is reasonable depends on the client.

c) Note that the Ninth Circuit ruled in *Black v. Commissioner,* 765 F.2d 862 (9th Cir. 1985), that the transfer of property jointly owned with a right of survivorship to a revocable trust severed the joint tenancy (and placed the property beyond the reach of IRC §2040).

D. Titling Trust Property.

1. When property is transferred to a joint trust (or any other trust), the assets should be titled consistent with the intent of the clients regarding whether the property is joint or separate.

2. Assets must be transferred to and re-titled in the name of the trustees (or the trust) in order to get the probate avoidance benefits of a joint trust.

3. Practitioners may use a schedule with the trust agreement to list assets intended to be made part of the trust. This can be useful to show intent, and many have been successful in using such a schedule to convince the relevant parties that the trustees are the owners of property following the death of a trustor. However, it is always best to follow the formalities of changing title.

a) ORS 130.150(1)(b) allows a property owner to create a trust by declaring that the owner holds the property as trustee. Some practitioners rely on this statute[5] to "fund" a trust by declaring in the trust agreement that the trustor is transferring all property listed on an attached schedule. This method is likely valid for transferring ownership of jointly-held property to the joint fund of a joint trust, where both owners/trustors serve as the trustees. It also is likely to be respected for tangible personal property and other assets that can be transferred by signing an assignment.

[5] Prior to the adoption of the Oregon Uniform Trust Code, some practitioners relied on Oregon case law, including Samuel v. King, 186 Or App 684, rev den 335 Or 443 (2003).

b) Note that using a schedule and a declaration based on ORS 130.150(1)(b) may not accomplish a transfer of separate property to the joint fund of a joint trust, where both spouses serve as trustee, nor would it be effective in any other case where the original owner(s) and the trustee(s) are not identical.

c) In any case, third parties may insist on reviewing an instrument of title for some types of property, regardless of the existence of a schedule and assignment or declaration within the trust agreement.

4. In general, assets that are part of the joint fund should be titled as:

   Ned Flanders and Maude Flanders, Trustees of the Flanders Family Joint Trust u/a/d November 13, 2020.

5. Clients may have limited, specific assets that they prefer to maintain as their separate property. Any such assets should be clearly titled as such. For example:

   Ned Flanders and Maude Flanders, Trustees of the Maude Flanders Share of the Flanders Family Joint Trust u/a/d November 13, 2020.

   a) Any separate assets held by a joint trust should be treated as belonging 100% to the owner spouse.

   b) Example: Maude inherited a beach house from her mother. She wants it to pass to her sons on her death even if Ned survives her. The beach house should be titled as Maude's separate property.

   c) Remember, if the clients have a lot of separate assets and they prefer to keep it that way, the joint trust is not their best estate planning tool.

6. As we all know, some clients choose a revocable trust (joint or separate) but still prefer to maintain title to some assets as tenancy by the entirety or joint with right of survivorship.

a) Failure to title property in a revocable trust risks that probate may be required if the last owner spouse dies before transferring all assets to his or her revocable trust. A probate proceeding defeats a significant planning purpose of revocable trusts.

b) There may be rational thinking behind some of these choices. For example:

(1) Oregon does not recognize that real property owned as tenants by the entirety maintains the same status if transferred to a joint revocable trust.[6]

(2) Some clients may be overwhelmed (or perturbed) by the prospect of having to open a new checking account -- and update all direct deposits and autopays -- just to put the same account in their revocable trust.

c) If clients do not want to move property to their revocable trust, one option is to use Pay on Death or Transfer on Death designations, effective at the death of the owner spouse (for separate property) or the surviving spouse's death (for joint assets). The trust, or the appropriate fund of the joint trust, should be the designee. See ORS 708A.495 (financial institutions), 59.540 (securities).

7. Practical Pointers

a) Technically, title is held by the trustees, subject to the terms of the trust agreement. In reality, each institution where the client has assets will have its own naming conventions.

[6] For comparison, Virginia statute permits property held by spouses as tenants by the entirety that is transferred to joint or separate revocable trusts to maintain creditor protection. Virginia Code §55.1-136(C).

b) Respect the formalities of title. If property is held by the trustees, the trustees should sign legal documents (including checks) as “Trustee.”

c) The taxpayer identification number for a joint trust while both trustors are living can be either trustor’s SSN. After the death of the first spouse, the Decedent Fund and any trusts funded by it will need a separate TIN (unless all assets are simply passing to the Survivor Fund).

III. ADMINISTRATION OF A JOINT TRUST AT THE FIRST DEATH

A. Trust Division and Funding.

1. On the death of the first spouse, all property in the joint trust is allocated to the “Decedent Fund” or the “Survivor Fund.”

a) In a joint trust that follows our recommended hybrid trust format, the trust agreement will direct that:

(1) The Decedent Fund consists of the decedent’s separate share assets (if any) and one-half of the joint fund assets.

(a) The Decedent Fund is irrevocable as of the moment of the deceased spouse’s death.

(b) The Decedent Fund is distributed according to the terms of the trust agreement, as in a single trustor revocable trust.

(2) The Survivor Fund consists of the surviving spouse’s separate share assets (if any) and the other half of the joint fund assets.

(a) The Survivor Fund remains revocable.

(b) The survivor may want to restate the trust agreement for the Survivor Fund so that it is more like a single trustor revocable trust.

b) Each of the Decedent Fund and the Survivor Fund should be funded with a pro rata interest in each and every joint fund asset.[7]

(1) If funding from joint fund assets is not pro rata, the transfer should be treated as a sale.

(2) Example: The joint fund assets include a residence and a brokerage fund, both of which are worth $1,000,000. The entire brokerage fund is allocated to the Decedent Fund, which will fund a Credit Shelter Trust. The entire residence is allocated to the Survivor Fund, which is revocable by the surviving spouse. The surviving spouse will be treated as purchasing 50% of the residence with 50% of the brokerage fund. The surviving spouse may recognize gain associated with the transfer of $500,000 from the brokerage fund in exchange for the residence.

2. After the decedent's estate is administered, all debts, expenses of administration and any taxes are paid and specific distributions are made from the Decedent Fund, the remaining assets are distributed according to the trust agreement:

a) Outright to the Survivor Fund, with or without a disclaimer trust option waiting in the wings; or

b) To a Credit Shelter Trust, with any excess to a marital deduction trust and/or outright to the Survivor Fund. If

[7] Respected Oregon practitioners may take the position that that pro rata funding is not required. For a technical discussion of this perspective, see Stephen J. Klarquist, *Avoiding Hazards in Drafting Joint Trusts*, PROBATE & PROPERTY (July/August 1999).

appropriate under the funding formula written in the trust agreement, these trusts may be funded non pro rata with assets from the Decedent Fund. The concerns raised in Section III.A.1.b are not applicable to the funding of sub-trusts within the Decedent Fund.

B. Maude's Estate Tax Return.

1. The executor responsible for filing the federal Form 706 and/or the Oregon OR-706 should report any assets held in a revocable trust on Schedule G. In this example, Schedule G should include:

    a) Assets from Maude's separate share, and

    b) 50% of the assets held in the joint fund -- unless Maude had a general power of appointment over the entire joint fund. If Maude held a general power of appointment over the joint fund, 100% of the joint fund should be reported on Schedule G. See Section III.C.3.

2. As with any Oregon estate, the trustee may make inconsistent elections over the Credit Shelter Trust for federal and state estate tax purposes.

    a) Ned and Maude's joint trust agreement includes the full complement of estate tax planning trusts.

    b) Maude's gross estate is $3,041,500. This is Maude's separate property and one-half of the joint fund.

    c) Assuming no expenses or specific gifts are paid from the Decedent Fund, and ignoring any deductions other than the marital deduction:

        (1) $1,000,000 will pass to the Credit Shelter Trust (exempt from both Oregon and federal estate tax at both deaths).

        (2) The balance ($2,041,500) will pass to a trust that qualifies for the Oregon QTIP or OSMP

election. These trust assets qualify for the unlimited marital deduction from Oregon estate tax in Maude's estate, and will be included in Ned's gross estate for Oregon estate tax purposes.

(a) If a federal QTIP election is made, these assets will be included in Ned's gross estate at his death.

(b) The trustee should make the "portability" election on Maude's Form 706, so that her federal estate tax exemption (in excess of $1,000,000) will be available for Ned's use during lifetime and at his death.

C. Basis Adjustments: the opportunity to be aggressive exists.

1. The Decedent Fund should receive a full basis adjustment described in IRC §1014(a). Like a single trustor revocable trust, the Decedent Fund consists of assets that the deceased spouse contributed to the trust and over which the deceased spouse retained the power to revoke or amend. IRC §2038, §1014(b)(2), (b)(3).

2. The Survivor Fund, consisting of the surviving spouse's separate share and a one-half interest in the joint fund, does not receive a basis adjustment. These assets should not be included in the deceased spouse's gross estate, unless…

3. What if the deceased spouse holds a general power of appointment over the entire joint fund -- including the surviving spouse's portion of the joint fund?

   a) In general, if a person holds a testamentary general power of appointment, property subject to the general power is included in the decedent's estate (IRC §2041) and receives a basis adjustment under IRC §1014(b)(9).

b) The IRS has ruled that giving the deceased spouse a general power of appointment over the Survivor Fund means that:

(1) The Survivor Fund is included in the deceased spouse's estate under IRC §2041, and

(2) The deceased spouse will be treated as the transferor of any property included in the deceased spouse's estate because of IRC §2041; however

(3) Although it is included in the deceased spouse's estate, no basis adjustment is allowed for the Survivor Fund because IRC §1014(e) bars any basis adjustment to property that is contributed by the surviving trustor and returned to the surviving trustor directly or indirectly (ie, in a Credit Shelter Trust) as a result of the surviving trustor failing to exercise the general power of appointment. *See* PLR 9026036, 200101021, 200210051.

c) Reasonable practitioners disagree with the IRS position that a basis adjustment of the Survivor Fund is not allowable by reason of IRC §1014(e). The primary counter argument is that a trust for the benefit of the surviving spouse (i.e., a Credit Shelter Trust) is not the same person as the surviving spouse.

d) Private Letter Rulings are binding only on the taxpayer who requests them. The IRS has not issued any other authority on this question.

4. Basis Consistency -- don't forget the details! When the beneficiary sells inherited property, the beneficiary must calculate capital gains (or loss) using the adjusted basis as described in IRC §1014(a). The beneficiary's tax basis in property must be consistent with the values reported on the decedent's estate tax return. IRC §1014(f). For federally

taxable estates, the executor must file IRS Form 8971 with the IRS and provide a schedule to each beneficiary that shows the adjusted basis of each inherited asset.

D. Avoiding Gifts to Remainder Beneficiaries.

1. If the entire joint trust becomes irrevocable following the death of the first spouse, the surviving spouse will be deemed to have made a gift to the remainder beneficiaries. Treas. Reg. §25.2511-1.

    a) This is the result of the surviving spouse contributing their property to an irrevocable trust, thereby completing a gift on the death of the first spouse.

2. There are two fairly simple ways to avoid a completed gift of the surviving spouse's assets and avoid this risk.

    a) Ensure that at least the surviving spouse's share continues to be revocable by the surviving spouse. This is typical. The surviving spouse may restate the trust agreement so that it is more like a single trustor revocable trust agreement. Treas. Reg. §25.2511-2(b).

    b) Give the surviving spouse a limited power of appointment over the irrevocable trust created at the death of the first spouse. The ability to change the disposition of the assets at the surviving spouse's death keeps the gift from being complete while the surviving spouse is living. Treas. Reg. §25.2511-2(b).

E. Funding a Credit Shelter Trust.

1. The Credit Shelter Trust should be funded with assets from the Decedent Fund.

2. If a Credit Shelter Trust is funded with property that is attributable to a contribution by the surviving trustor and the surviving trustor is a beneficiary of the Credit Shelter Trust,

there is a risk that the Credit Shelter Trust will be included in the surviving spouse's estate under IRC §2036.

a) When Ned and Maude contribute jointly-owned property to the joint trust, each is contributing an equal share of each jointly-owned asset. If the joint fund is allocated equally between Ned and Maude and the Credit Shelter Trust is funded solely from the Decedent Fund (consisting of the deceased trustor's contributions to the joint trust), there should be no 2036 concerns.

b) If Ned and Maude contribute separately-owned property with un-equal values to the joint fund and the trust agreement is silent about the allocation of joint fund assets, then each spouse is treated as the transferor of the property he or she contributed.

   (1) In this scenario, each spouse has contributed property to a trust for his or her own benefit and retained the right to revoke or amend that trust, and to transfer the contributed property back to himself or herself. Under IRC §2036, the trust assets are included in the transferor spouse's gross estate at death.

   (2) If the "poorer" spouse is the first to die, and the trust agreement directs a 50/50 division of the joint fund, then property contributed by the "richer" surviving spouse could pass to the Credit Shelter Trust. If so, some portion of the Credit Shelter Trust would be included in the surviving spouse's gross estate under IRC §2036(a)(1).

   (3) To avoid this IRC §2036 problem, consider "equalization" of interests in the joint fund (regardless of the value contributed by each spouse), as discussed in Section II.B.

IV. TRUST ADMINISTRATION AT SURVIVING SPOUSE'S DEATH

A. Failure to Fund Credit Shelter Trust at First Spouse's Death.

1. Sometimes, clients will not consult with their advisors following the death of the first spouse. The surviving spouse will carry on managing the trust assets as trustee. On the death of the surviving spouse, advisors and the successor trustee will realize that the terms of the trust agreement were not followed after the death of the first spouse.

2. Question: Can we claim that a portion of the assets were set aside in trust? Usually, we want to argue that a Credit Shelter Trust was funded to utilize the Oregon estate tax exemption.

    a) Evaluate how the client handled the assets. In one recent administration, the client had a separate account funded with the deceased spouse's assets. The surviving spouse took the income. That is, it was administered like a separate trust consistent with the terms of the trust agreement. Compare this with the surviving spouse putting the funds in their own investment account, liquidating the funds and buying real estate in their own name.

    b) How was the income reported for income tax purposes? If no separate trust was formed, the trust was not filing income tax returns. If the surviving spouse recognized income, is that generally consistent with what would have been reported and paid if a separate trust was funded?

    c) If you determine it is reasonable to take the position a separate trust was funded, ensure your client understands that it may be challenged. If Oregon DOR (or the IRS) successfully challenges the position taken on the return, the estate and the tax liability will increase.

3. Consider the breach of trust by the trustee at the first death.

    a) Technically, the trustee did not follow the terms of the trust agreement following the death of the first spouse.

    b) There is a potential for claims by remainder beneficiaries.

B. Ned's Estate Tax Return.

1. Assuming that Ned, as trustee, properly funded and administered the Credit Shelter Trust, those assets will not be included in his gross estate for estate tax purposes.

2. On Ned's estate tax return(s), Ned's executor will report the value of any non-trust assets Ned owned, the Survivor Fund, and any Marital Trust includable in Ned's gross estate.

    a) Non-trust assets will be reported on the appropriate Schedules.

    b) The Survivor Fund assets will be reported on Schedule G.

    c) If a federal QTIP election was made over a Marital Trust, the Marital Trust assets will be reported on Schedule F.

    d) If an Oregon-only QTIP election or an OSMP election was made over a trust for Ned's benefit, those assets will be excluded from Ned's gross estate for federal estate tax purposes but reported on Schedule F for Oregon estate tax purposes.

C. Income Tax Basis.

1. Credit Shelter Trust assets. Assets in a Credit Shelter Trust received a basis adjustment at Maude's death, are not included in Ned's estate, and will not receive a second basis adjustment at Ned's death.

2. Marital Trust assets.

   a) Assets in a federal QTIP trust will receive a full step-up in basis at Ned's death.

   b) Assets in a trust treated as a Credit Shelter Trust for federal estate tax purposes will not receive a second basis adjustment at Ned's death for federal income tax purposes. However, if those assets are subject to an Oregon-only QTIP or OSMP election, and thus included in Ned's gross estate for Oregon estate tax purposes, they will receive a basis adjustment for Oregon income tax purposes when Ned dies. *See* ORS 118.010(8) (allowing elections on Oregon estate tax returns that are inconsistent with similar elections on federal estate tax returns) and ORS 316.716(1)(d), (e) (requiring an increase or decrease in the federal taxable income reported on an Oregon income tax return for the year in which an asset is sold, to reflect any difference between the basis in an asset under federal law and Oregon law). *See also* Jones, Philip, "Inconsistent Elections and Basis in Oregon" in the July 2017 OSB Estate Planning and Administration Section Newsletter.

3. Survivor Fund assets. The Survivor Fund (Ned's revocable trust assets) will receive a full basis adjustment at Ned's death. The same is true for any of Ned's assets passing outside the trust that are otherwise eligible for a basis adjustment under IRC §1014.

V. DRAFTING THE JOINT TRUST AGREEMENT

This section includes practical pointers for drafting a joint trust agreement for Ned and Maude Flanders, taking into consideration the tax and other issues described above.

A. Clients' Roles and Retained Rights.

1. Client Roles.

Ned and Maude will be the trustors, trustees,[8] and initial beneficiaries of their joint trust. As trustors, they will approve the trust provisions and create the trust by signing the trust agreement. Then, they will transfer assets from their individual names to (themselves as) the trustees of the joint trust. As trustees, they will hold and manage the assets on behalf of (themselves as) the joint trust beneficiaries, while they are both living.

2. Ability to Revoke the Joint Trust and Withdraw Trust Property.

To avoid making completed gifts to the remainder beneficiaries when funding the joint trust, Ned and Maude should each retain the right to revoke the trust agreement and withdraw the trust property. Those rights will be reserved to them as trustors.

Should they be required to act jointly to revoke the Trust? Ignoring their powers as trustees for a moment, should either of them be allowed to withdraw 100% of the trust property without notice to or consent of the other spouse? What happens to the joint trust property if they initiate divorce proceedings? What if one spouse loses capacity? The answers to these questions depend, in part, on how the property is characterized within the joint trust: as a joint fund belonging equally to both spouses, as separate shares for each spouse, or some property in a joint fund and other property in one or more separate shares. This issue is discussed in Section II.B. The answers also depend on the tax consequences of each possible approach.

To avoid the tax pitfalls discussed in Section II.B, the authors prefer to draft joint trusts with a joint fund for all "joint"

[8] It is not necessary for both Ned and Maude to serve as trustees but most clients prefer this arrangement, as long as both spouses are living and have capacity.

assets, with each spouse having an undivided one-half interest in all joint fund assets. As described in Section II.B., each spouse should have the unilateral right to revoke the joint trust as to his or her share, and to withdraw his or her half of the joint fund assets.

B. Allocation of Trust Property: Avoiding Adverse Results.

1. Estate Tax Issue.

As discussed in Section II.B.1, consider allocating half of the property in the joint fund to each spouse, regardless of the source of the property. This alleviates the risk of inclusion of Credit Shelter Trust assets in the surviving spouse's gross estate under IRC §2036.

2. Gift Tax Issue.

Take care to avoid taxable gifts upon the transfer of un-equal property by one spouse to the joint trust. See Section II.C for trust provisions designed to qualify such transfers for the gift tax marital deduction.

3. Potential for Divorce and/or Trust Revocation.

As noted in Section II.B.1.c, equalizing the spouses' interests in contributions to the joint fund can affect their rights in the trust property upon divorce or revocation and withdrawal of the joint trust property. Be sure that the clients understand that contributing their separate property to the joint fund is a true transfer of property rights.

C. Estate Tax Planning in the Trust Agreement.

At the death of the first spouse, the trust agreement should instruct the trustee to divide the trust assets into the Decedent Fund and a Survivor Fund, as described in Section IIII.A. Then, the trust agreement should instruct the trustee how to further divide and/or distribute the Decedent Fund assets, following the estate tax plan included in the trust agreement.

Oregon estate tax planning should be a consideration for couples who may own more than $1,000,000 at the time of the first spouse's death, and it may be appropriate to consider federal estate tax planning for couples whose gross estates may exceed the federal estate tax exemption amount at the time of death. The Oregon estate tax exemption is not "portable" between spouses. Therefore, the estate of the first spouse to die must use the Oregon estate tax exemption at his or her death.

The following are examples of the considerations and some general approaches to estate tax planning within a joint trust.

1. Non-Tax Plan.

    a) Generally for spouses who do not have Oregon or federal estate tax concerns (less than $1,000,000 in assets). May also be useful for a single asset, such as a piece of real estate.

    b) Both spouses contribute all assets to the trust and hold them in a joint fund. This is where the joint-fund-only approach described in Section II.B.1 may be ok.

    c) On the death of the first spouse, all assets pass to the Survivor Fund and the surviving spouse can revoke or amend the trust agreement. Importantly, the surviving spouse will control the disposition of all trust assets.

    d) Not designed for estate tax planning (or couples with trust issues).

2. Disclaimer Plan.

    a) As in non-tax plans, the disclaimer plan provides that all assets pass outright to the surviving spouse (or the Survivor Fund). If the surviving spouse disclaims their interest in any of the deceased spouse's assets, those assets pass to a "disclaimer trust" for the benefit of the surviving spouse.

b) In a disclaimer trust plan, it is important that each spouse has a right to one-half of any joint assets and all of such spouse's separate assets. That is, "Separate Shares" or the "Hybrid Approach" must be used.

c) The surviving spouse can disclaim all or any portion of the deceased spouse's assets (subject to the qualified disclaimer rules found in IRC §2518).

(1) Note that the IRC does not specifically authorize a disclaimer of assets held in a joint trust. For authority, you may wish to refer to the following Regulations.

(2) Joint tenancies with a right of survivorship: upon the death of the first joint tenant, the surviving joint tenant may disclaim the one-half of the property in which they have a survivorship interest, regardless of the source of contribution. Treas. Reg. §25.2518-2(c)(4)(i).

(3) Joint bank/brokerage accounts:

(a) The ability to disclaim depends on relinquishment of control. Treas. Reg. §25.2518-2(c)(4)(iii).

(b) If the contributing spouse retains the ability to control the transferred funds, the gift is completed at death. The non-contributing spouse could disclaim funds on the death of the first spouse.

3. Credit Shelter Trust (and Variations).

a) Some clients prefer not to rely on the surviving spouse to execute a disclaimer for estate tax planning purposes. Instead, they may want to establish an irrevocable Credit Shelter Trust to be funded with the first $1,000,000 of the deceased spouse's assets (the Oregon estate tax exemption amount). Some clients prefer to fund a Credit Shelter Trust with the federal estate tax exemption amount. The clients may prefer to use a marital deduction trust for any assets in excess of the estate tax exemption amount; others prefer to distribute those assets outright to the surviving spouse.

b) Some clients have non-tax reasons for creating a Credit Shelter Trust (and marital deduction trust, to the extent needed) for the surviving spouse. Clients who have children from previous relationships may want to ensure that their respective shares of the joint trust assets are preserved for their respective children, to the extent possible, and are not subject to changes in the surviving spouse's estate plan.

c) The Credit Shelter Trust plan (or similar tax planning approaches) must use "Separate Shares" or a "Hybrid" approach to establish each spouse's portion of the joint fund. Any trust funded on the death of the first spouse should be funded with the deceased spouse's portion of the joint fund. This limits any risk of the surviving spouse being deemed a contributor to the trusts for the surviving spouse's benefit and the issues discussed in Section III.E.

4. The clients may choose to give the deceased spouse a general power of appointment over ALL the joint trust assets.

a) For those who are interested in this technique, refer to Section III.C.

(1) IRS guidance tells us that giving the first spouse to die a general power of appointment over the joint fund ensures that the deceased trustor is the transferor of property transferred to the Credit Shelter Trust and therefore there are no 2036 problems.

(2) Giving the first spouse to die a general power of appointment preserves the opportunity to claim a basis step up on the entire joint fund.

(3) This is easy to do and we sleep better. Right?

b) Some clients and practitioners may not be comfortable with giving the first spouse to die a general power of appointment that is really complete control of the joint trust (or joint fund) assets.

(1) What if the deceased spouse exercised the general power? Suppose that on Maude's death, her separate counsel produces a validly exercised general power of appointment appointing all joint trust assets in the Flanders Family Joint Trust to Seymour Skinner. What is Ned to do?

(2) I am tossing and turning again...

D. Tax Basis Planning.

1. Consider whether to grant a general power of appointment over the entire trust fund to the first spouse to die. See discussion in Sections III.C, V.C.4.

2. If clients want to direct a particular asset or sum to a Credit Shelter Trust (rather than to the Survivor Fund, with or without a disclaimer option), consider:

a) Assets in a traditional Credit Shelter Trust will not receive a second basis adjustment at the surviving spouse's death.

(1) If the Credit Shelter Trust owns an interest in the trustors' primary residence, the Credit Shelter Trust will not qualify for the capital gain exclusion under IRC §121.

(2) For this reason, the clients may prefer to leave the primary residence to the Survivor Fund.

(a) The surviving spouse may have the opportunity to disclaim the inherited portion of the residence, if holding the property in the Credit Shelter Trust is more advantageous than preserving the ability to claim the IRC §121 exclusion.

(b) The surviving spouse will have his or her own $250,000 capital gain exclusion for any portion of the residence held in the Survivor Fund. IRC §121(b)(1)

(c) If 100% of the primary residence is held in the Survivor Fund, the surviving spouse may be able to claim a $500,000 capital gain exclusion if he or she sells the residence within two years of the first spouse's death. IRC §121(b)(4).

b) Consider drafting a Credit Shelter Trust that qualifies for the QTIP election. Following the death of the first spouse, the trustee can decide whether a second basis adjustment at the surviving spouse's death would be more advantageous than excluding the credit shelter property from the surviving spouse's gross estate.

VI. FINAL THOUGHTS: WHEN TO USE OR AVOID JOINT TRUSTS

A. Estate Tax Considerations.

1. For a Non-Taxable Estate

a) A joint trust probably makes sense for a married couple who already own most or all of their assets jointly, and whose combined gross estates are unlikely to exceed $1,000,000. Consider, on a case-by-case basis, whether and to what extent to include protective tax planning language in the trust agreement.

b) For non-taxable estates, the trust agreement could provide that the deceased spouse's share is distributed outright to the survivor’s share.

(1) The decedent’s share qualifies for the unlimited marital deduction

(2) The survivor’s share remains revocable, and the ultimate disposition of trust assets is in the survivor’s hands.

(3) All trust assets are included in the surviving spouse’s gross estate at his or her death.

2. For Oregon-Taxable Estates.

With careful planning to avoid taxable gifts between spouses, estate inclusion of Credit Shelter Trust assets under IRC §2036, and other potential pitfalls, joint trusts can be appropriate for an Oregon resident couple with assets exceeding $1,000,000. See Sections II, III.E.

3. For Estates Exposed to Federal Estate Tax.

Proceed with caution when using a joint trust for a married couple whose estates are likely to be subject to federal estate tax. The increased stakes (and scrutiny) that accompany larger estates can magnify the consequences of mistakes in joint trust planning for the federally taxable estate.

B. Non-tax Reasons to Avoid Joint Trusts.

1. Blended Families.

Spouses with children from prior relationships probably will be unwilling to reallocate un-equal trust contributions to each other. Consider, also, the complexity of drafting different dispositive plans for each spouse's property within the same trust agreement.

2. Spouses who Wish to Preserve Separate Property.

   Spouses with marital agreements preserving the separate property status of their assets also are unlikely to want to allocate un-equal trust contributions equally between themselves. These clients probably will be better served by separate revocable trusts.

3. Spouse who is Not a U.S. Citizen.

   Joint trusts are not appropriate when one spouse is not a U.S. citizen because of the different requirements in planning for the marital deduction during the spouses' lifetimes and at death. See IRC §2523(i) (disallowing the unlimited marital deduction for gift tax purposes when gifts are made to a non-citizen spouse) and IRC §2056(d) (disallowing the unlimited marital deduction for estate tax purposes when gifts are made to a non-citizen spouse).

C. Other Practical Considerations.

1. Consider preserving the community property status of assets brought to Oregon from other states. See Section I.D.1.

2. Consider the clients' ownership of existing assets. Do the clients already own most property jointly, or do they tend to keep their assets separate? See Sections I.D.2 and VI.B.2.

3. Consider any difficulties or disadvantages of re-titling assets. Some clients will not be inclined to re-title their assets. See discussion in Section II.D.6.

4. Consider the compatibility of clients' wishes and plans. If the spouses have different beneficiaries and dispositive plans in mind for their separate property, it may be more efficient to draft separate revocable trusts for each of them.

D. So far, nothing terrible has happened…

Some of the tax risks and drafting complexities described above can be daunting. Joint trusts are a useful tool for many clients, however, despite these hurdles.

It's possible that we haven't all observed 100% of the drafting and funding best practices at all times, that clients have made mistakes in administering joint trusts during their lifetimes, and that trustees have made mistakes following a trustor's death. Despite the likelihood that technical errors have occurred, to the authors' knowledge, the IRS has not contended that

- An Oregon resident made taxable gifts to a spouse when contributing an un-equal amount to a joint trust, or
- Credit Shelter Trust assets should be included in the surviving spouse's gross estate under IRC §2036, due to the presence of assets originally contributed to a joint trust by the surviving spouse.

EXHIBIT A: ASSET LIST

Ned and Maude Flanders

ASSET	JOINT	NED	MAUDE	COMMENTS/PLAN	STATUS
Real Estate					
Primary Residence	750,000			Transfer to Flanders Family Joint Trust. Advise clients that a trust cannot own property as tenants by the entirety (In Oregon), resulting in loss of creditor protection.	
Beach House			600,000	Transfer to Trust, deed should reflect title in Maude's Separate Share.	
Checking/Savings					
Joint Checking	10,000			Assign to Flanders Family Joint Trust, but consider convenience and client's tolerance for changing autopay and direct deposit. Alternative recommendation is to use a "payable on death" account and name the Flanders Family Joint Trust as the beneficiary.	
Joint Savings	100,000			Assign to Flanders Joint Trust.	
Ned's Checking		5,000		POD to Ned's Separate Share of the Flanders Family Joint Trust.	
Maude's Checking			10,000	POD to Maude's Separate Share of the Flanders Family Joint Trust.	
Brokerage (Non-retirement)					
Joint Investments	400,000			Assign to Flanders Family Joint Trust.	
Ned's Investments	600,000			Clients want to title as joint. Have Ned transfer to trustees of the Joint Trust. Consider transfer to Ned and Maude, JTWROS before transferring to trust.	
50 shares of Fox Corp stock			1,500	Clients want to title as joint. Obtain transfer agent paperwork and determine steps to transfer to Joint Trust. Again, consider transfer to Ned and Maude, JTWROS before transfer to the joint trust. Alternative - consider whether it is an option to transfer these shares to the joint brokerage account?	

ASSET	JOINT	NED	MAUDE	COMMENTS/PLAN	STATUS
Retirement Plans					
Ned's IRA		1,000,000		Retirement plans cannot be owned by a trust.	
Maude's 401(k)			500,000	Remind client to review beneficiary designations.	
Closely Held Businesses					
100% interest in Leftorium, LLC	1,000,000			Assign membership to Flanders Joint Trust. Review Operating Agreement, ensure compliance with terms related to assignment.	
100% interest in Dee-Diddly, Inc. (S Corp)		400,000		S Corp stock. Title stock in Ned's separate share of the Flanders Family Joint Trust. Review Shareholder Agreement, terms related to assignment.	
				Note: A shareholder's revocable trust may be an S Corp shareholder because it is a grantor trust. IRC §1361(c)(2)(A)(i)	
				On the death of the trustor, grantor trust status terminates. Generally, the trust can hold the stock for up to two years without risking its status as an eligible shareholder. IRC §1361(c)(2)(A)(ii).	
Life Insurance					
Policy on Maude's life			$500,000	Designating the trust as a beneficiary will ensure that proceeds pass consitent with the decedent's estate plan. In general, be specific, such as naming the "Maude Flanders Share of the Flanders Joint Trust u/a/d November 13, 2020." The life insurance proceeds *will* be included in the decedent's estate.	
TOTALS	$2,860,000	$1,405,000	$1,611,500	**Total Estate:**	
Gross Estate - Maude's death (first)			$3,041,500	**$5,876,500**	