WYATT TARRANT & COMBS LLP

Community Property Joint Revocable Trust

A new Tennessee law, effective July 1, 2010, allows spouses to create a Joint Revocable Trust and convert all of their assets to "Community Property." A Community Property Trust has many advantages over a traditional Revocable Trust or a Will. First, it allows a husband and wife to keep all the assets titled jointly in the name of the trust. Second, it has a significant income tax benefit for the surviving spouse. Third, it insures that at least one-half (1/2) of the assets in the trust will be available to utilize the death tax exemption of the first spouse to die.

A Community Property Joint Revocable Trust can be created by both spouses during their lives if it meets the following four requirements: (1) The trust agreement states that it is a Tennessee Community Property Trust; (2) At least one Trustee is a Tennessee resident; (3) It is signed by both spouses; and (4) It contains a notice of the tax and legal consequences of the trust.

How it Works

You and your spouse retain the right to amend the trust acting together, and either spouse may revoke and recover his/her one-half of the trust assets. In the event of divorce, the trust will be divided in the same manner as marital property, which generally means equitably between the spouses as they agree, or if they are unable to agree, as the court determines.

At the death of the first spouse, one-half of the property in the trust will be used to create various trusts for the surviving spouse for his/her lifetime. The trusts created for the surviving spouse are primarily designed to reduce death taxes upon the death of the surviving spouse. The other one-half of the property remaining in the trust will continue as a Revocable Trust under the control and direction of the surviving spouse.

The surviving spouse can serve as Trustee over all trusts created and can have full access and control of all assets contained within all trusts created. The surviving spouse can also decide how assets in the trust pass to the children through a Limited Power of Appointment in the event circumstances change following the death of the first spouse.

When both spouses are deceased, the assets from all trusts created will be divided among the designated residuary beneficiaries, presumably your children, either outright or in trust.

The advantages and disadvantages of a Joint Revocable Trust must be considered before making a final decision.

Advantages

1. Simplicity. The Joint Trust allows a couple to keep all assets titled jointly. Without this trust, it is necessary to separate assets for death tax reasons into each spouse's individual name.

2. More Efficient Planning for Death Tax. Because everything is titled jointly in the trust, at least one-half of all assets in the trust will always be available to utilize the death tax exemption of the first spouse to die. It is common for couples without this type of trust to waste at least part of the death tax exemption because they do not monitor changes in assets over time and the first spouse to die often does not have sufficient assets in his or her individual name at the time of his/her death.

3. Income Tax Advantage. The Joint Revocable Trust provides a significant income tax advantage for the surviving spouse because assets in the trust will be considered the "community property" of both spouses. Since 1948, Internal Revenue Code Section 1014(b)(6) has granted a full "step up" in basis for ALL community property owned by a couple upon the death of the first spouse (as opposed to only the assets in the decedent's individual name). This allows the surviving spouse to sell any asset in the trust virtually income tax free, provided a sale occurs soon after the death of the first spouse. This can be extremely beneficial to the surviving spouse who needs to diversify an investment portfolio, to sell a closely held business, or to liquidate any other asset with a low income tax basis.

   The 1948 law was enacted to address a tax inequality between residents of community property states and residents of non-community property states. Although the need for the full step up in basis for community property states was eliminated in the 1976 Tax Act, the 1948 law has never been repealed. Attempts to repeal the income tax advantage (including two as recently as the Clinton administration) have thus far been unsuccessful due to the lack of support of the community property states.

4. Probate Avoidance. A benefit of all Revocable Trusts is that they avoid the delay, hassle, expense, and public nature of probate administration upon death and/or disability (called a Conservatorship). Although having a Durable Power of Attorney Covering Financial Affairs often avoids a Conservatorship in the event of disability, many financial institutions prefer dealing with a Trustee rather than an attorney-in-fact.

5. Asset Management. Preparing and funding the trust requires you to review, list, and organize your assets. This process often leads to consolidation of assets and accounts, and even rediscovering forgotten assets. All of the above makes it much easier for the Trustee to manage the trust upon death or disability.

Disadvantages

1. Funding. One disadvantage is the time and effort that is required to properly fund the trust. Funding the trust is crucial because the advantages are only available if the trust owns your assets. The advisors must work together, with the client, to insure that all assets (with limited exceptions) are titled in the name of the trust or are payable to the trust upon death.

2. Cost. Another disadvantage of the trust is the higher cost to prepare and implement the trust. Whereas a Will only provides for one scenario (i.e. death), a Revocable Trust provides for four different scenarios: (1) Grantors are alive and healthy, (2) the Grantors are disabled, (3) one Grantor is deceased, and (4) both Grantors are deceased. Additionally, there are the costs involved in funding the trust as discussed above.

3. Asset Protection. Real estate owned by the trust may not have as much protection from lawsuits and creditors as it would if owned by a husband and wife together as tenants by the entirety. However, assets of the deceased spouse held in trust for the surviving spouse or children are protected. Clients may want to consider increasing their personal liability ("umbrella") policy.

4. Gift Tax Issues on Formation. There can be gift taxes incurred upon formation of the trust if it is not drafted correctly. Therefore, this trust should be prepared only by an experienced estate planning specialist.

Conclusion

A Community Property Joint Revocable Living Trust is not for every family. However, if your goals are to minimize death tax, assure proper management of assets in the event of disability or death, avoid probate, minimize income taxes upon the sale of assets following death and cause your assets to be held in a trust under the joint control and management of both spouses, a Community Property Trust deserves serious consideration. The advantages are too substantial to ignore.

A. Stephen McDaniel
Wyatt, Tarrant & Combs, LLP
901.537.1000
smcdaniel@wyattfirm.com

C. Michael Adams, Jr.
Wyatt, Tarrant & Combs, LLP
901.537.1000
madams@wyattfirm.com