OLD DOG OR NEW TRICK?
THE EVOLUTION OF JOINT SPOUSAL TRUSTS IN TODAY'S ESTATE PLANNING

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I. JOINT SPOUSAL TRUSTS IN COMMON LAW STATES

A. I believe it is fair to say that joint spousal trusts in most common law states have not historically been top-of-mind or the instrument of choice for draftsmen with respect to their married couple clients.

1. In the states of Missouri and Kansas, the use of joint trusts historically was primarily promoted by the "Trust Mills", who would crank out an estate plan for a married couple for the convenient price of $999. This factor alone caused many of us to run the other direction from consideration of the use of joint trusts.

2. Many common law practitioners are aware that joint trusts are the instrument of choice in community property estates, and fit that regime like a glove. All of this has led to some common law practitioners feeling the opposite about joint trusts in the common law context.

B. For those of us who overcame these practical and psychological barriers, in the era of lower estate tax exemptions and higher estate tax rates, and greater IRS scrutiny of marital deduction trust drafting, the thought of recommending a joint trust for a married couple who might be in a taxable situation upon their deaths led us to pursue the path of

least resistance, i.e., the traditional separate revocable trusts for each spouse with credit shelter trust planning approach.

C. What is a Joint Spousal Trust?

1. For purposes of this presentation, my definition of a Joint Spousal Trust is a revocable trust instrument whereunder the two (2) spouses are the settlors of the revocable trust, and most often name themselves as the initial co-trustees of the revocable trust.

2. The rubber meets the road when we consider the specifics of what happens to the trust property on the incapacity or death of the first spouse, and again on the incapacity or death of the second spouse.

3. The specific provisions of the Joint Spousal Trust become even more tricky in the context of a second marriage with children from one or both previous marriages, and even more problematic if that situation also involves common children of the current spouses. Suffice it to say, in this author's view, if the two (2) spouses do not see eye to eye on the dispositive provisions after their respective deaths, the Joint Spousal Trust may not be a viable vehicle for that couple. (Obviously, if the

spouse's differences become irreconcilable, the draftsman may not be ultimately involved in the preparation of either spouse's estate plan!)

II. DRAFTING ISSUES FOR THE JOINT SPOUSAL TRUST

A. Unlike community property states, we are not concerned with specific scheduling of certain property to be held in certain trust shares. In community property states, it is common for these joint trusts to include a Schedule A for one spouse's separate property, Schedule B for the other spouse's separate property, and Schedule C for "marital property".

B. Future Divorce Concerns.

1. With separate revocable trusts for each spouse, we always give cautionary advice as far as the impact of funding of each of these separate trusts on any future divorce of the married couple. With the Joint Spousal Trust, we must cover this issue upfront as we draft the trust.

2. In the drafting, it is common in my jurisdiction to provide for the theorical creation of a share for each spouse. Absent specific indication to the contrary, joint assets which are transferred to the Joint Spousal Trust will be allocated in one-

half theoretical shares to each spouse's respective share of the joint revocable trust. It is also possible for a spouse to direct that separate property be held in that spouse's share of the Joint Spousal Trust, creating something other than a 50/50 division of Joint Spousal Trust assets.

3. The draftsman must explain to the clients the potential impact that this theoretical trust share creation may have in the context of a later divorce of the married couple.

C. Estate and Income Tax Issues Triggered by the Use of Joint Spousal Trusts.

1. As long as the Trust is revocable by the Settlors, it should be ignored for federal income tax purposes. Our counsel to our clients is to use either or both spouse's social security numbers as the tax identification number for this Trust during the time which it is revocable.

2. This can get more complicated if the spouse's file separate income tax returns, and gain and income earned by the Joint Trust must be split between those two returns.

3. Estate tax issues upon the death of the first spouse.

a. As the subsequent discussion in this outline suggests, my approach is to provide for the theoretical division of the Trust assets into a share for spouse A and a share for spouse B.

b. Under my drafting approach, upon the death of spouse A, all of the assets held in that theoretical share are included in A's gross taxable estate for federal estate tax purposes.

c. There is no question that, in this era of sky-high estate/gift tax exemptions, our focus is more on income tax planning. In that vein, some commentators have suggested a more aggressive approach, which involves giving the <u>first</u> spouse to die a general power of appointment over <u>all</u> of the assets held by the Joint Spousal Trust, in an attempt to obtain a complete step up in basis for income tax purposes for all of the Joint Spousal Trusts on the death of the <u>first</u> spouse.

d. In common law states, we have "basis-envy", as under Internal Revenue Code Section 1014(b)(6), all community property owned by a married couple receives a step-up in basis upon the death of the first spouse.

There is no such statutory blessing for common law states.

e. In fact, the limited law out there is not on our side. Under PLRs 2001021 and 200210051, the IRS has held that such a full step up in basis does not occur under a Joint Trust which gives the first spouse to die a general power of appointment over the entire Joint Spousal Trust. Admittedly, the basis for the IRS conclusion is somewhat tortured (i.e., they presume a deemed gift by the surviving spouse to the deceased spouse of one-half of the Trust assets at the moment of death, preventing a Section 1014 step-up as to those assets). Nonetheless, no contrary authority exists at this time.

f. If you have an aggressive client, and you believe that fortune favors the bold, you may try this approach. You may be a hero, and make new law for all of us. For the moment, my opinion is that this remains fool's gold.

4. My two-share approach provides clarity as to the assets available to fund any credit shelter trust on the first spouse's death, as well as negating any argument that Internal Revenue

Code Section 2036 applies to any assets in the non-deceased spouse's share upon the first spouse's death.

5. If credit shelter trust planning is part of this Joint Spousal Trust, then the normal curtailments on the surviving spouse's powers as trustee should be included, as well as curtailing the surviving spouse's power to revoke or amend the Credit Shelter Trust, just as you would in a single spouse's revocable trust which provides for the surviving spouse to serve as sole successor trustee of such a Trust.

D. Creditor Protection.

1. I believe you at least have a credible argument that the creditors of one spouse cannot touch the separate share under the Joint Spousal Trust of the non-debtor spouse.

2. We have a unique creditor protection opportunity in **some** tenancy by the entirety states.

III. JOINT SPOUSAL TRUSTS IN TENANCY BY THE ENTIRETY STATES

A. The concept of tenancy by the entirety.

1. Tenancy by the entirety is a unique form of property ownership between a husband and wife, whereby each owns the undivided whole of such property.

a. Under this concept, a husband and wife takes and holds the property, not as separate individuals, but as one person, each together holding the entire property.

b. In a tenancy by the entirety, neither husband or wife is deemed to own a part of the property, but both of them are deemed to own the entire estate.

c. Because of this inherent characteristic of tenancy by the entirety, neither spouse can dispose of any part of the property held in tenancy by the entirety, without the consent/joinder of the other spouse.

2. Another characteristic of tenancy by the entirety is a right of survivorship, so that upon the death of one spouse, the surviving spouse is entitled to the whole property.

3. A unique aspect of tenancy by the entirety is that the creditors of an individual spouse may not attach the interest of such spouse in assets held as tenants by the entirety.

a. This is a critical attribute, particularly for those individuals who face higher risk of personal liability (i.e., medical professionals, attorneys, accountants, business owners, etc.), and an attribute with which such

individuals are not very willing to part.

b. If both spouses are indebted to a creditor, then tenancy by the entirety assets may be attached by such creditor.

4. In some states, like Missouri, there is a strong presumption that assets held, or once held, by a husband and wife, are held as tenants by the entirety.

a. In other states, the touchstone for the existence of tenancy by the entirety is the expression of intent to so establish such tenancy.

b. Yet other states focus on the presence of certain "unities," of interest, time, title and possession.

B. Twenty-six (26) states recognize some form of tenancy by the entirety between spouses. A list of such states is included in the attached Exhibit A.

C. As asset protection planning has escalated in importance over the last several years, the protection provided by tenancy by the entirety status in these states must be considered in the estate planning completed for clients with property in such states.

D. Recent Reminder of the Super-Creditor Status of the IRS!

1. In U.S. v. Gerard, (D.C. Ind. 4/9/18), we are reminded that

federal tax liens attach to the taxpayer's interests in property held as tenants by the entirety notwithstanding state las. See also United States v. Craft, 535 U.S. 274 (2002).

2. The method of valuing the taxpayer's interests in the property is still somewhat uncertain. Most circuits have allowed the government to attach half of the property, but a few have applied actuarial tables.

E. Tenancy by the Entirety and the Use of Trusts

1. For married couples with taxable estates who are also sensitive to maintaining creditor protection, the choice between funding revocable trusts and maintaining tenancy by the entirety status creates great tension.

a. Traditionally, if the couple divided tenancy by the entirety property between husband's revocable trust and wife's revocable trust, the property no longer enjoyed tenancy by the entirety protection from the creditors of one spouse.

b. If tenancy by the entirety property was transferred to a joint trust created by a husband and wife, it was at best uncertain in most jurisdictions as to whether the property

would continue to be protected from the creditors of one of the spouses.

2. The Evolution of the Qualified Spousal Trust

a. In a very few tenancy by the entirety states, the spector of transferring tenancy by the entirety property to a revocable trust and retaining the characteristics of tenancy by the entirety has been raised by case law.

b. Missouri

(1) In Bolton Roofing Company, Inc. v. Hedrick, 701 S.W. 2d 183 (Mo. App. 1985), the Missouri Court of Appeals held that assets previously held in tenancy by the entirety by a married couple which was transferred to a trust jointly created by husband and wife, with husband as sole trustee of the trust for the benefit of husband and wife, held that the creditor of one spouse could not attach such property.

(2) Although the Bolton Roofing court did not expressly say that the property transferred to the trust retained its characteristics as tenancy by the

entirety property, it has been cited many times in Missouri as precedent for such a proposition. See In Re: Bellingroehr, 403 B.R. 818 (U.S. Bankr. Ct. W.D. Mo. 2009).

c. Hawaii

(1) In Security Pacific Bank Washington v. Chang, 80 F. 3d 1412 C.A. (9th Cir. 1996), the Federal Appellate Court was very critical of the Bolton Roofing holding in reversing a district court judgment which refused to allow a creditor to attach real estate held in a trust by one spouse, when said real estate was previously held as tenants by the entirety prior to transfer to the Trust.

(2) The Security Pacific Bank Washington court held that: "[t]here is no reason to suppose that the Hawaii Supreme Court would afford such protections in a situation such as the one presented here or in Bolton, where the debts arose after severance of the tenancy by the entirety and where the former entirety property was transferred, at

least in part, to the spouse who later incurred the debt."

(3) It should be noted that, in contrast to the Bolton Roofing case, the Security Pacific Bank Washington case involved a transfer of tenancy by the entirety to two separate trusts created by each spouse.

d. Pennsylvania

(1) In 1943, the Supreme Court of Pennsylvania held that a Pennsylvania trust established by a married couple, with a bank as the trustee, created a tenancy by the entirety interest in the corpus of the trust when they made unequal contributions of securities to the trust. In Re: McEwen's Estate, 33 A.2d 14 (Pa. 1943).

(2) The McEwen Court made its holding on two separate grounds:

(a) Husband and wife reserved the right to control the disposition of the trust corpus by revocation, termination or modification of

the trust during their lifetimes, and upon revocation of the trust, the trust assets were to have vested in the McEwens as tenants by the entirety.

(b) Secondly, the Court reasoned that the McEwens held a mere equitable ownership in the trust principal, which was subject to the tenancy by the entirety interest.

(3) This holding appears to be based on a now obsolete concept that the trust beneficiary merely held an in personam right in the trust, i.e., a right of action only against the trustee, and not a property interest in the trust. The modern trend of tenancy by the entirety cases recognizes that the beneficiary has both a right of action against the trustee and an actual property interest in the trust.

e. Florida

(1) In a Florida Bar Journal article authored by R. Craig Harrison, entitled "Trusts: TBE or not TBE", he suggests that tenancy by the entirety

property may be transferred to a revocable trust and still retain its tenancy by the entirety status in Florida. Harrison, "Trusts: TBE or Not TBE", Florida Bar Journal (May 2013).

(2) Relying upon statements made in First National Bank v. Hector Supply Co., 254 So. 2d 777 (Fla. 1971) and Beal Bank, SSB v. Almand and Associates, 780 So. 2d 45 (Fla. 2001), the author contends that a trust can be drafted to expressly set forth the intention of the husband and wife to create or maintain tenancy by the entirety and establish six essential characteristics associated with tenancy by the entirety property, namely, unity of possession, unity of interest, unity of title, unity of time, the right of survivorship, and the fact of marriage.

(3) Many other Florida practitioners strongly disagree that tenancy by the entirety creditor protection may be continued after transfer to a revocable trust.

3. History repeats itself!

(a) Many of the first patriots of our great nation heralded from the colony of Virginia, which obviously became the Commonwealth of Virginia of the United States of America.

(b) In 2001, the Commonwealth once again led the way by enacting the first statute expressly providing that tenancy by the entirety property could be transferred to a revocable trust, and retain the creditor protection aspect of tenancy by the entirety property. A few technical glitches were cleaned up by the Virginia legislature in 2006.

c. Subsection B. of Virginia Code Section 55-20.2 provides as follows:

> "any property of a husband and wife that is held by them as tenants by the entireties and conveyed to their joint revocable or irrevocable trusts, or to their separate revocable or irrevocable trusts, and any proceeds of the sale or disposition of such property, shall have the same immunity from the claims of their separate creditors as it would if it had remained a tenancy by the entirety, so long as (i) they remain husband and wife, (ii) it continues to be held in the trust or trusts, and (iii) it continues to be their property.

d. Kudos to Virginia for stepping out and breaking the mold

of the notion that the concept of tenancy by the entirety and revocable trust/estate tax planning for married couples was irreconcilable. Nonetheless, this initial statutory effort raises a few questions.

(1) Although the concept of the Qualified Spousal Trust was born by this statute, the statute also says that the trust can be either a revocable or an irrevocable trust, and may be a joint trust with both of the spouses as the settlors or to separate trusts with respect to which one spouse is the settlor.

(2) As specified in the Virginia statute, continued creditor protection (i.e., "the same immunity" from the claims of each individual spouse's creditors) depends upon three requirements, the third of which is that the property "continues to be **their property**." (emphasis added)

(a) One wonders what "their property" means?

(b) Perhaps the intention is that the ownership of the property must "look like" what we would regard as typical tenancy by the

entirety property.

(c) The 2006 technical correction makes clear that this language does NOT require both spouses to be beneficiaries of each trust or each share of the joint trust. However, does this language require that both spouses be co-trustees?

4. It appears that the remainder of the tenancy by the entirety states did not immediately jump on the Qualified Spousal Trust band wagon.

   a. It was not until 2010 that Delaware and Maryland enacted the Qualified Spousal Trust concept, followed by Indiana, Illinois and Missouri in 2011, Hawaii in 2012 and Wyoming in 2013.

   b. Tennessee enacted such a statute in 2014 and North Carolina came on board in 2015.

   c. The state of Arkansas just passed their own statute, which has an effective date of January 1, 2020, BUT applies to trusts created before and after that date.

5. Common characteristics of statutes which authorize the

establishment of Qualified Spousal Trusts.

a. Must the Qualified Spousal Trust cite the supporting state statute in the governing instrument?

   (1) The applicable states are split.

   (2) Probably a good practice, in any event.

b. Must the property contributed to a Qualified Spousal Trust be held as tenancy by the entirety property immediately prior to the transfer of such property to the Qualified Spousal Trust?

   (1) Delaware, Maryland, North Carolina, Tennessee, Virginia and Wyoming contain this express requirement.

   (2) It is not clear from the Illinois or Indiana statutes that this is a requirement.

   (3) Arkansas and Missouri do not require this.

c. Does the state statute permit the Qualified Spousal Trust to be split into two separate shares while both spouses are living?

   (1) It appears that all eleven of the existing statutes allow this to occur.

d. Does the state statute permit the first deceased spouse's trust share of the Qualified Spousal Trust to be split into separate shares upon such first death (i.e., a marital/non-marital division under typical estate tax planning)?

(1) Illinois specifically disallows such a division.

(2) The Arkansas and Missouri statutes clearly allow such a division.

(3) The other eight states appear to allow such a division, at least by implication.

(4) If such a division is permitted, then this also presents a non-tax planning opportunity, as the credit shelter trust created upon the first spouse's death can be sheltered from the surviving spouse's creditors (whereas, with regular tenancy by the entirety, all of such assets remain exposed to the survivor's creditors).

(a) Note that the Maryland QST statute specifically precludes this result. See Md. Est. & Tr. Code § 14-113(c)(2).

6. Judicial Attack on the Qualified Spousal Trust.

a. In Re Brewer, 544 B.R. 177 (2015), a federal bankruptcy court dealt expressly with a qualified spousal trust created under the auspices of the Missouri statute authorizing such a trust.

b. Facts of the Case.

(1) Ronald and Teresa Brewer created the Brewer Trust on September 10, 2014, and transferred title to their home to themselves as Co-Trustees of the Brewer Trust. It was undisputed that the residence was held in tenancy by the entirety immediately prior to the transfer to the Brewer Trust, and it was also undisputed that the Brewer Trust was intended to be a Qualified Spousal Trust pursuant to R.S.Mo. § 456.950. This trust was designed to be a single trust for both spouses pursuant to the Missouri statute.

(2) Ronald and Teresa Brewer were the settlors, the co-trustees and the primary beneficiaries of the Brewer Trust. The Bankruptcy Court found that the trust instrument preserved the "survivorship

feature" of tenancy by the entirety, in that either or both of the settlors could exercise dominion and control over any and all of the trust assets.

(3) The trust instrument also provided that "During the existence of this trust, each Grantor shall have the right to partition, enabling such Grantor to restrict, transfer, or withdraw one-half of the assets in this trust."

(4) On December 5, 2014, less than three (3) months after creating and funding the Brewer Trust, Ronald and Teresa Brewer filed a joint Chapter 7 Bankruptcy Petition, and claimed that the home was exempt property under the applicable bankruptcy statute on the basis that their ownership of the home remained in a tenancy by the entirety.

c. The Bankruptcy Court held that the home titled in the Qualified Spousal Trust was <u>not</u> exempt for bankruptcy purposes.

(1) The <u>Brewer</u> court held that tenancy by the entirety

property in Missouri requires the “four unities” (interest, title, time, and possession).

(2) The Brewer court also held that the Qualified Spousal Trust statute requires that the settlors as beneficiaries “act together”, that each have right to hold property or receive distributions from “the entire trust”, and that these rights continue during the joint lives of the settlors and for the survivor’s life.

(3) The Brewer court then focused on the above-described “partition” language and held that “the right to partition is not only fundamentally inconsistent with the requirement that each settlor have the right to distributions from the entire trust for the joint lives of the settlors”, but is inconsistent with the nature of tenancy by the entirety property itself.

d. Missouri trust and estate practitioners strongly agree that the Bankruptcy Court simply got this wrong.

(1) The Bankruptcy Court imposes terms on the

Qualified Spousal Trust statutes that are not only missing from that statute, but that are in direct contravention of the exact wording of the statute.

(2) The old saying that "bad facts make bad law" was probably true in this case, as the trust was created and funded less than three (3) months before the filing of bankruptcy, and the use of the word "partition" was unwise.

(3) Nonetheless, the court is absolutely wrong that Missouri law requires the "four unities" in order for tenancy by an entirety exists; rather, since 1961, Missouri courts have held that the **intent** of a married couple as to how joint property shall be held is controlling.

(4) Although the use of the word "partition" was unfortunate, the statute clearly allows a Qualified Spousal Trust to be held as one trust or to be held and administered in two separate trusts or two separate shares of one trust for the benefit of each of the settlors, with the trust being irrevocable by

each settlor with respect to that settlor's separate share of the trust without the participation or consent of the other settlor, and with each settlor having the right to receive distributions whether mandatory or within the discretion of the trustee from that settlor's separate share for that settlor's life.

e. While the Brewer decision sent initial shock waves through the trust and estate community in Missouri, trust and estate practitioners believe that the decision is wrong and continue to use Qualified Spousal Trusts actively in their practices

7. Unless the applicable state statute provides to the contrary (i.e., like Maryland), one advantage that a Qualified Spousal Trust will have over traditional tenancy by the entirety assets is, upon the death of the first spouse to die, any assets that flow into the Credit Shelter Trust that includes a valid spendthrift clause will not be subject to the surviving spouse's creditors (thus potentially cutting the surviving spouse's creditor issues in half!).

8. Implications for prenuptial and postnuptial agreements.

a. For a couple contemplating marriage involving property situated in a tenancy by the entirety state which recognizes Qualified Spousal Trusts, and where there is a desire to create joint property as to some assets immediately after the new marriage, consider including provisions in a prenuptial agreement which require that a Qualified Spousal Trust be created to hold such assets.

b. If a husband and wife decide to convert separate property to tenancy by the entirety property in order to transfer such property to a Qualified Spousal Trust, you should consider having them execute in advance a post-nuptial agreement which specifies their intended post-divorce and post-first death rights in such property.

(1) Each spouse will obviously need separate counsel in order to make such an agreement enforceable.

(2) Consider serving as a “scrivener” of the post-nuptial agreement, and then having each seek independent advice as to the actual execution of such agreement.

9. What if you practice in a state that is not one of the eleven (11) tenancy by the entirety states which have enacted statutes authorizing Qualified Spousal Trusts?

a. If you are in non-tenancy by the entirety state, it is probably a long shot that your state will suddenly switch to a tenancy by the entirety concept.

b. However, if your clients own property which has a situs in a tenancy by the entirety state, be mindful of the possible existence of a separate Qualified Spousal Trust option for such property, either currently or in the future (i.e., to achieve probate avoidance for such property while maintaining the creditor protection of tenancy by the entirety).

c. If you practice in a tenancy by the entirety state that does not currently have a Qualified Spousal Trust concept, I highly recommend it!

IV. PLANNING OPPORTUNITIES WITH JOINT SPOUSAL TRUSTS

A. Non-Taxable Estates.

1. In tenancy by the entirety states, a Joint Spousal Trust fits like a glove for married couples with a combined estate that does not

require estate tax planning under any reasonably assumed scenario (i.e., for us, this usually means a couple in their 60s or older with a combined gross estate which is not close to the $7,000,000 watermark); and whose dispositive desires are in sync.

2. For these couples, it should not take a great effort to craft a Joint Spousal Trust that satisfies their dispositive objectives, with no worries with respect to marital deduction or credit shelter trust planning.

3. For these couples, their usual objectives are probate avoidance while maintaining their normal course of household financial operations. A Joint Spousal Trust works like a charm for these folks.

B. "Possibly" taxable estates.

1. In our view, a "possibly' taxable estate involves a married couple with a combined estate which may be subject to federal estate tax under one or more reasonably assumed scenarios (i.e., a combined estate equal to or exceeding the $7,000,000 level, either currently or reasonably projected to do so in the future).

2. We often suggest a "disclaimer trust" option.

a. When the trust is created, the trust estate is initially "divided" into two separate shares of the Joint Trust for the benefit of each settlor.

b. For estates of this size, it is very common for us to suggest a disposition that says, upon the death of the first spouse, everything in the first spouse's share of the Joint Trust shall be left to the surviving spouse, with the provision that if the surviving spouse disclaims any part of this disposition, then such disclaimed portion shall be left to a credit shelter trust.

c. One obvious disadvantage to this approach is, in order for the disclaimer to be qualified, the surviving spouse cannot have a special power of appointment over the credit shelter trust assets.

d. One obvious advantage of this approach is to postpone the decision as to whether or not a credit shelter trust is needed until the death of the first spouse to die.

e. If there is a state estate tax that applies to part of the estate, post mortem disclaimer planning can be used to minimize the overall state estate tax paid by the couple.

3. Another approach with estates in this category is the "Clayton option".

   a. Under this option, upon the death of the first spouse to die, such spouse's share of the Joint Spousal Trust shall pass to a trust which qualifies for QTIP treatment.

   b. The Trustee can then decide whether or not a partial QTIP election should be made for federal estate tax purposes.

   c. This is probably a cleaner approach when you may need to make a QTIP election for state estate tax purposes only.

   d. To the extent the QTIP election is not made, then the remaining "non-elected" assets may pass to a credit shelter trust, relying upon the holding in the Clayton case. (Keep in mind that there may be legitimate non-tax reasons for assets to pass to a credit shelter trust, i.e., creditor protection for spouse and/or other beneficiaries; wanting a spray trust structure that would include spouse, children and grandchildren, etc.)

C. "Taxable" Estates

1. This includes couples with a combined estate which currently exceeds the $22,800,000 threshold.

2. The Joint Spousal Trust shall provide that, upon the death of the first settlor/spouse to die, that spouse's trust assets shall be separated into a marital share/credit shelter trust, using traditional formula funding language.

    a. Each separate share of the Joint Spousal Trust must be revocable only by one settlor, without the need for consent of the other settlor/spouse.

    b. Each settlor shall have the right to receive either mandatory or discretionary distributions from that spouse's separate share of the Joint Trust for the settlor/spouse's life.

V. COMMUNITY PROPERTY TRUSTS (The presenter wishes to give credit to Naples, Florida attorney Travis Hayes, whose materials form the basis for much of this section.)

A. Common law states have sought to allow married couples to opt in to community property treatment.

1. In June, 2021, Florida adopted legislation which will permit the creation of community property trusts in that state.

2. Alaska was the first state to enact legislation permitting residents of common law states to establish community property trusts in its state (in order to convert property owned in a common law jurisdiction into community property). Tennessee (2010), South Dakota (2016), Kentucky (2020), and now Florida have joined this exclusive club by adopting community property trust acts, allowing both residents and non-residents to contribute property to a community property trust established in those states.

3. Each of these states currently provide that property acquired by a married couple is separate property, but allow the couple to elect to treat it as community property if such property is transferred to and held in a community property trust.

4. Each of these "community property trust states" have specific statutes authorizing the creation of community property if held in a specific type of trust. The community property trust statutes for the five states which have enacted legislation are very similar and have many of the same provisions and requirements. The Florida, Kentucky and South Dakota acts, being the most recently enacted, in contrast to the older Alaska

and Tennessee statutes, include a specific statement that the laws comply with the requirements of IRC § 1014(b)(6).

B. Will the IRS Respect Florida Community Property Trust Legislation for Purposes of IRC § 1014(b)(6)?

1. Under two Tax Court cases, *Westerdahl v. Commissioner*, 82 T.C. 83 (1984); and *Angerhofer v. Commissioner*, 87 T.C. 814 (1986), 282 U.S. 101 (1930), the proposition that opt-in community property trust legislation would be effective in transmuting separate property to community property for purposes of IRC § 1014(b)(6) is supported. However, these Tax Court cases involved whether the community property laws of Sweden and Germany, respectively, created community property for purposes of the Internal Revenue Code. In these cases, the determinative factor of whether the married couple could treat property as community in nature turned on whether each spouse had a vested interest in the property.

2. The conclusion which can be drawn from these cases is that if a state incorporates characteristics of the community property statutes from the eight original community property jurisdictions in its community property trust legislation, it

should be respected by the IRS (or at least by the Tax Court if the IRS challenges a taxpayer's classification of property as community in nature).

C. Florida Requirements for community property trust**.**

1. The requirements to establish a Florida Community Property Trust, as set forth in Fla. Stat. Section 736.1503, are as follows:

a. The trust agreement (all Florida Community Property Trusts must be in writing) expressly declares the trust is a Florida Community Property Trust governed by the FCPTA.

b. At least one trustee must be a "qualified trustee" (i.e., a trustee located in Florida). The settlor spouses may serve as co-trustee of the Florida Community Property Trust even if they are located out-of-state, so long as they are serving with a qualified trustee.

c. The trust agreement must be signed by both spouses. A trust which is signed by only one of the spouses will not qualify as a Florida Community Property Trust under the FCPTA. Additionally, most community property trusts will have testamentary effect, in which case the trust

agreement must be executed with the formalities required for the execution of a Will in this state.

d. The following provision must be contained at the beginning of the trust agreement:

THE CONSEQUENCES OF THIS COMMUNITY PROPERTY TRUST MAY BE VERY EXTENSIVE, INCLUDING, BUT NOT LIMITED TO, YOUR RIGHTS WITH RESPECT TO CREDITORS AND OTHER THIRD PARTIES, AND YOUR RIGHTS WITH YOUR SPOUSE DURING THE COURSE OF YOUR MARRIAGE, AT THE TIME OF A DIVORCE, AND UPON THE DEATH OF YOU OR YOUR SPOUSE. ACCORDINGLY, THIS TRUST AGREEMENT SHOULD BE SIGNED ONLY AFTER CAREFUL CONSIDERATION. IF YOU HAVE ANY QUESTIONS ABOUT THIS TRUST AGREEMENT, YOU SHOULD SEEK COMPETENT AND INDEPENDENT LEGAL ADVICE. ALTHOUGH NOT A REQUIREMENT, IT IS STRONGLY ADVISABLE THAT EACH SPOUSE OBTAIN THEIR OWN

SEPARATE LEGAL COUNSEL PRIOR TO THE EXECUTION OF THIS TRUST.

2. Fla. Stat. § 736.1504. Agreement establishing community property trust; amendments and revocation.

a. This section describes the terms that **may** be agreed to by settlor spouses in a Florida Community Property Trust. In the trust agreement, the settlor spouses may: (1) determine rights and obligations regarding property in the community property trust; (2) describe the management and control of the trust property; (3) set forth the disposition of trust property upon dissolution, death or other event (subject to Fla. Stat. §§ 736.1507 and 736.1508, which are discussed below); (4) declare whether the trust is revocable or irrevocable; (5) establish any other lawful term of the trust which does not otherwise destroy the community property status of the assets transferred to the trust (this is meant to be a savings clause).

b. Section 736.1504 provides that the default for a Florida Community Property Trust is that it is revocable. (To the

contrary, the Alaska, Tennessee and South Dakota statutes provide that the default is that the trust is irrevocable.

c. A surviving spouse may amend the terms of a Florida Community Property Trust as to that spouse's one-half interest in the trust, regardless of whether the trust is otherwise irrevocable.

d. While both settlor spouses are living, they shall be deemed to be the only qualified beneficiaries (within the meaning of Fla. Stat. § 736.0103(16)) of the trust. After the death of a spouse, the surviving spouse is deemed to be the only qualified beneficiary as to that spouse's one-half share of the trust. These provisions apply regardless of whether the trust is revocable or irrevocable.

3. Fla. Stat. § 736.1505. Classification of property as community property; enforcement; duration; management and control; effect of distributions.

a. Section 736.1505 provides all property held in the trust is community property under the laws of the State of Florida during the marriage of the settlor spouse. The

section goes on to specifically provide that if property is distributed from a Florida Community Property Trust, it is no longer community property under the FCPTA. However, the distributed property may retain its character as community property if it was such prior to the contribution to the trust under the laws of a different state or foreign jurisdiction, or under the Florida Uniform Act.

b. This is also the section which provides that there is no requirement that the settlor spouses be domiciled in Florida in order to avail themselves of the FCPTA.

4. Fla. Stat. § 736.1506. Satisfaction of obligations. This section describes creditors' rights against a married couple who have established a Florida Community Property Trust.

a. Protected homestead is specifically excluded from this section.

b. As to non-homestead property held by the trust, (1) an obligation of one settlor spouse (whether incurred before or during the marriage) may only be satisfied from that spouse's one-half of the trust; and (2) an obligation of

both settlor spouses (i.e., a joint debt) may be satisfied from any of the trust assets.

5. Fla. Stat. § 736.1507. Death of a spouse**.** Section 736.1507 sets forth that the surviving spouse's one-half share of the trust is not subject to testamentary disposition by the deceased spouse or under any laws of succession in Florida. The deceased spouse's one-half share of the trust is subject to testamentary disposition by that spouse.

6. Fla. Stat. § 736.1508-1509 Dissolution of marriage.

   a. This section provides that the Florida Community Property Trust will terminate upon the dissolution of the settlor spouses' marriage, with one-half of the trust assets being distributed to each spouse.

   b. Fla. Stat. § 736.1509 provides that a Florida Community Property Trust shall not affect the right of a child of either settlor spouse who is required to be provided child support.

7. Fla. Stat. § 736.151. Homestead property. Section 736.151 specifies that homestead property transferred to a Florida Community Property Trust retains its homestead character (i.e.,

the property tax exemption, the protection from creditors, and the restrictions on devise). The section also specifically provides that property acquired in the name of the trustee of the Florida Community Property Trust may initially qualify as the settlor spouses' homestead, provided that the property would qualify as the settlor spouses' homestead if title was held outside of the trust in one or both of the spouses' individual names.

8. Fla. Stat. § 736.1511. Application of Internal Revenue Code; community property classified by another jurisdiction.

    a. This section specifically provides that the assets in a Florida Community Property Trust are considered community property under Florida law for purposes of establishing the taxable basis under IRC § 1014(b)(6).

9. Fla. Stat. § 736.1512. Unenforceable trusts.

    a. Section 736.1512 provides that a Florida Community Property Trust may be found to be unenforceable if: (i) the terms were unconscionable when made; (ii) the spouse against whom enforcement is sought did not enter into the agreement voluntarily; (iii) the community

property trust agreement was the product of fraud, duress, coercion, or overreaching; or (iv) the spouse against whom enforcement is sought did not receive fair and reasonable financial disclosure, did not waive disclosure, and did not have notice of the other spouse's finances.

EXHIBIT A

TENANCY BY THE ENTIRETY STATES AND QUALIFIED SPOUSAL TRUSTS

	Allow Joint Trusts to Qualify for T by E Creditor Protection?	**Must the QST State Statute be Specifically Cited in the Trust or Instrument of Conveyance?**	**Must the Property Be Held as T by E Property Immediately Prior to Transfer to Joint Trust?**	**Does State Statute Permit the Joint Trust to be Split Into 2 Separate Shares While Both Spouses Are Living?**	**Does State Statute Permit the First Deceased Spouse's Trust Share to be Split Into Marital/Non-Marital Shares?**
Alaska* **	No				
Arkansas	Yes (Arkansas Code Section 28-72-601, et seq.)	No	No	Yes	Yes
Delaware	Yes (12 Del. Code Sec. 3334)	No	Yes	Yes	Uncertain
District of Columbia	No				
Florida	Maybe**				
Hawaii**	Yes (Haw. Rev. Stat. Sec. 509-2)**	Yes	Yes	Yes	Uncertain
Illinois	Yes (765 1LCS 1005-1c****	No	Not expressly	Yes	No
Indiana**	Yes (IC 30-4-3-35)**	Yes	Not expressly	Yes	Yes
Kentucky**	No				
Maryland	Yes (Md. Est. & Tr. Code Sec. 14-113)	No	Yes	Yes	Yes

Massachusetts	No				
Michigan	No				
Mississippi	No				
Missouri	Yes (Mo. Rev. Stat. Sec. 456.950)	No	No	Yes	Yes
New Jersey	No				
New York**	No				
North Carolina**	Yes (N.C. Gen. Stat. Sec. 39-13.7)**	No	Yes	Yes	Uncertain
Ohio*****	No				
Oklahoma	No				
Oregon**	No				
Pennsylvania	No				
Rhode Island**	No				
Tennessee	Yes (T.C.A. Sec. 35-15.510)	Yes	Yes	Yes	Uncertain
Vermont	No				
Virginia	Yes (Va. Code Sec. 55-20.2)	No	Yes	Yes	Uncertain
Wyoming	Yes (W.S. 4-10-402(c)-(e)	Yes	Yes	Yes	Uncertain

* Alaska is studying the possibility of such a statute.

** This state allows tenancy by the entirety status for real estate only.

*** Florida practitioners disagree as to whether a joint trust may qualify for tenancy by the entirety creditor protection, but there is no specific enabling statute.

**** Illinois allows tenancy by the entirety status for the “homestead” only.

***** Only if created before April 4, 1985.