



In Praise of the Joint Revocable Trust



“Of all the joint revocable trusts, in all the towns, in all the world, she is a co-settlor and beneficiary of mine.”

Some people describe lawyers like me as “wills lawyers,” a description that never adequately captured much of what estate planners do but nowadays is even less accurate than it used to be. The heaviest lifting I do for estate planning clients is as a trust lawyer. Tennessee has aggressively modified its trust statutes in the ongoing effort to be an attractive trust jurisdiction and, as a result, most of my clients include detailed trusts in their estate plans.¹

The joint revocable trust (JRT) is becoming an increasingly common estate planning tool for married couples.² This article reviews some of the uses and advantages, and a few limitations, of such a trust. In all the scenarios described below, the trust is created by a married couple, both spouses retain some power to revoke or amend the trust, and the couple transfers

assets to the trust, names the trust as beneficiary of assets upon a spouse’s death, and/or has “pour over” wills that sweep into the trust all assets not already in the trust or otherwise passing to the trust.³

Routine Marital Estate Planning

The most basic role of a JRT is for a couple who simply wants all assets controlled by both spouses during life and then distributed to the correct beneficiaries at the second of their deaths. Like a will, the trust provides for the proper distribution of the assets at the second of the couple’s deaths. The JRT remains fully revocable and amendable by either or both spouses until the second of their deaths, so the survivor can access all assets and change the plan after the first death.⁴

There are several potential advantages

of a JRT over separate wills or separate revocable trusts. First, for shared assets and a shared estate plan, many couples more readily understand and embrace one joint trust than separate wills or trusts. Second, any revocable trust provides privacy because, while the terms of a probated will are public, the terms of a revocable trust are generally private to interested parties. Third, to the extent assets are transferred to the trust before death, they do not pass through probate.⁵ Lastly, the statute of limitations for challenging the validity of a revocable trust is shorter than the statute of limitations for challenging a will admitted to common form probate.⁶

Income Tax Planning

Another potential advantage of a JRT is that it can be made a Tennessee Community Property Trust (CPT), which might significantly reduce capital gain taxes for the surviving spouse after one spouse dies. In a separate property state like Tennessee, when the first spouse dies the survivor generally gets a one-half increase (step-up) in the income tax basis (the deemed investment for purposes of determining capital gain) of each appreciated, jointly owned asset.⁷ In a community property state (and for some assets brought from a community property state by a couple moving to Tennessee), appreciated community property gets a full basis step-up at the first death.⁸

For example,⁹ if a married couple has an income tax basis of \$1 million in an investment account and it is valued at \$2 million as of the first death, in a separate property state the potential capital gain is reduced from \$1 million (\$2 million value minus \$1 million basis) to \$500,000 by a

one-half increase in basis to fair market value [one-half of the basis (\$500,000) is stepped-up to one-half of the value (\$1 million), resulting in a basis for the survivor of \$1.5 million [\$1 million plus the surviving spouse's unadjusted one-half of basis (\$500,000)], reducing potential (long-term) capital gain taxes (15-20% for many of our clients) by \$75,000-100,000. However, in a community property state the potential capital gain is reduced from \$1 million to \$0 by a full increase in basis to fair market value (the full \$1 million basis is stepped-up to the full \$2 million value), reducing potential (long-term) capital gain taxes by \$150,000-200,000. Thus, the surviving spouse in a community property state has a potential tax advantage of \$75,000-100,000 over the surviving spouse in a separate property state.¹⁰

Several separate property states want the same potential benefit available to married couples in their state (without imposing the potential divorce implications of being a community property state), so they have created by statute elective community property. Tennessee joined the list with passage of the Tennessee Community Property Trust Act in 2010.¹¹ Assets that the couple transfers to the CPT before the first of the couple's deaths will be treated as community property (with several nontax legal implications) and will be eligible for a full basis adjustment at the first death.¹²

To be a CPT, one or both spouses must transfer property to the trust, which (1) expressly declares that it is a Tennessee CPT; (2) has at least one trustee who is a Tennessee resident (including one or both spouses) or a bank or trust company authorized to act as a fiduciary in Tennessee with at least certain administrative powers; and (3) contains a prescribed warning at the beginning of the trust. As you can see, once a lawyer is drafting a JRT it is not terribly difficult to make the trust a CPT.

Creditor Protection

If a married couple is more interested in creditor protection than full income tax basis step-up, the JRT can be drafted to

be a Tennessee Marital Asset Protection Trust (MAPT)/Tenancy by the Entireties Trust.¹³ If the couple owns assets as "tenants by the entirety" (TBE), neither spouse may unilaterally sever the tenancy and a creditor of one spouse may not do what the debtor may not do, meaning the creditor may not sever the TBE to reach the interest of the debtor-spouse.

In 2014 Tennessee added *Tenn. Code Ann.* Section 35-15-510, allowing a married couple to transfer TBE property to a trust with the property retaining the same immunity from the claims of the spouses' separate creditors as if the couple had continued to hold the property as TBE.¹⁴ Among the requirements of an effective MAPT are that the trust is, while both settlors are living, revocable by either settlor or both settlors acting together and both spouses are permissible current beneficiaries of the trust while living.

Even better than simple TBE ownership, after the first death any separate creditors of the surviving spouse may reach MAP trust assets only to the extent that the surviving spouse remains a beneficiary of the trust *and* possesses a *non-fiduciary* power to vest title to property in himself/herself individually. Thus, the surviving spouse can be a beneficiary and the sole trustee with broad *fiduciary* discretion to distribute for self. Because a surviving spouse's reserved power to amend and revoke the trust and a lifetime general power of appointment over the trust are inconsistent with protection of the assets from the survivor's creditors, a MAPT seeking this TBE-plus protection should be drafted so that between the two deaths the trust is eligible for an estate tax marital deduction. The trust, irrevocable by the surviving spouse, could include a formula testamentary general power of appointment for the surviving spouse in order to provide optimal basis increase for appreciated assets at the second death.¹⁵

Estate planners wish a trust could be both a MAPT and a CPT, but that appears impossible. *Tenn. Code Ann.* Section 35-17-106(a) specifically provides that

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the separate creditors of one spouse may reach that spouse's one-half interest in CPT assets, a result inconsistent with the rules for MAP Trusts. However, a married couple could have one CPT for appreciated capital gain assets and one MAPT for other assets (including depreciated capital gain assets).

Estate Tax Planning

An additional potential advantage of a JRT comes into play when a married couple's estate is valuable enough to cause federal estate taxes.¹⁶ Whether a CPT or MAPT, a JRT can be drafted to include federal estate tax (and generation-skipping transfer tax or "GST") planning elements, including an "A-B Trust" structure involving a "credit shelter trust" for the amount that can be exempted from estate tax and a "QTIP" marital deduction trust for the rest. A long string of IRS "private letter rulings" (PLRs) hold that a JRT that includes a testamentary general power of appointment for the first spouse to die makes all the JRT assets available to fund the credit shelter trust at the first death, a benefit unavailable without a JRT.¹⁷

Conclusion

A JRT is not appropriate for all married couples. However, many married clients should consider a joint revocable trust for privacy, income tax planning, creditor protection and estate tax planning. III

NOTES

1. See Smith, "If You Build It, They Will Come: Tennessee Pursues Trust Preeminence," *Tennessee Bar Journal*, September 2021, available at www.tba.org/Smith_TrustPreeminence; Holbrook, "3 Developments Enhance Tennessee's Drive to Be a Top Trust Situs," *Tennessee Bar Journal*, August 2019, available at www.tba.org/Holbrook_TopTrustSitus; Smith, "Shifting the Paradigm: Should Most Tennessee Trusts Last Indefinitely?" *Tennessee Bar Journal*, December 2017, available at www.tba.org/Smith_ShiftingtheParadigm; Smith, "In Tennessee, 'T' Stands for Trust," *Tennessee Bar Journal*, April 2017, available at www.tba.org/Smith_TStandsTrust.
2. Although many couples in second marriages, with blended families, or with separate assets include trusts in their estate plan, the joint revocable trust is often most appropriate for a long-term married couple with shared children and assets.
3. There are important estate planning, creditor protection and estate tax reasons to create irrevocable trusts, with little or no retained power to amend or otherwise alter the trust, but such trusts are not the subject of this article.
4. Because the surviving spouse has the rights to amend and revoke the entire trust, there should be no negative federal gift tax or estate tax implications. The surviving spouse has reserved powers to amend and revoke (as to that spouse's deemed contribution) and/or a general power of appointment (as to the deceased spouse's deemed contribution). Under the "grantor trust rules" of Internal Revenue Code/26 U.S. Code (IRC) §§ 671-679, all

income is taxable to the grantors during life.

5. Avoiding probate in Tennessee should only occasionally be a key goal because Tennessee probate is usually less difficult and less expensive than a Tennessee resident taking the steps necessary to avoid probate altogether. Avoiding probate might be a goal for out-of-state real estate, when no potential fiduciaries live nearby, or when testators simply want to get assets into the trust that ultimately will own and dispose of them.

6. *Tenn. Code Ann.* § 35-15-604 (as short as 60 or 120 days after the settlor's death, for trusts revocable immediately prior to the settlor's death) vs. *Tenn. Code Ann.* § 32-4-108 (two years from entry of the order admitting the will to probate).

7. IRC § 1014. Conversely, the survivor generally suffers a basis step-down for depreciated capital gain assets, because the income tax basis of each capital gain asset is adjusted to fair market value as of the date of death.

8. IRC § 1014(b)(6). A lawyer must analyze this issue for a married couple moving from a community property state (such as California) to Tennessee. Preserving community property status for appreciated property can result in significant tax savings for the surviving spouse.

9. Many of us became lawyers, in part, because we like words more than numbers, but follow the math here because the numbers can be quite large for our clients, who are very appreciative when we save them a lot more money than we bill them.

10. In addition to reducing capital gains taxes upon sale, a higher basis can provide greater deductions for depreciable property.

11. *Tenn. Code Ann.* § 35-17-101 et seq.

12. If the surviving spouse has rights to amend and revoke the entire trust, appreciated assets remaining in the JRT at the second death will be eligible for another basis step-up.

13. See *Tenn. Code Ann.* § 35-15-510; Smith, "New Tennessee Trusts MAP Route to Better Estate Planning for Married Clients," *Tennessee Bar Journal*, August 2014, available at www.tba.org/Smith_BetterEstatePlanningMarried.

14. In 2021 *Tenn. Code Ann.* Section 35-15-510 was changed from saying that after a transfer to the MAPT the transferred property "shall no longer be held by the husband and wife as tenants by the entirety" (stating the legal reality that the property is now owned by the trustee, not the spouses) to say that the property "is tenancy by the entirety property held by husband and wife subject to this section" (emphasis added in both versions). It is unclear how this can be true when the property

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has been transferred to the trustee, creating potential interpretive problems for title attorneys, litigators and others.

15. See Holbrook, "OBIT Power: The One Clause You Need (or Need to Add) in Every Irrevocable Trust," *Tennessee Bar Journal*, August 2018, available at www.tba.org/Holbrook_OneClauseYouNeed.

16. The federal estate tax "applicable exclusion amount" (exemption) in 2022 is \$12,060,000 per person, indexed annually for inflation. Because the exemption is "portable" between spouses, a married couple must have a net estate value exceeding \$24.12 million to have current estate tax exposure. The exemp-

tion is scheduled to be halved in January 2026, so a married couple might have a combined exemption of circa \$14 million (at 5% annual inflation).

17. Note, however, two potential issues with adding this feature. First, PLRs are binding as to the recipient taxpayers only, so other taxpayers cannot legally rely on them. (None-theless, the IRS has issued this type of PLR fairly consistently over the years, so perhaps taxpayers can be confident that they represent the Service's position.) Second, drafting a JRT with this feature is complicated. Any practitioner doing so must meticulously follow the fact patterns of the PLRs.

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78. *Commercial Appeal* (Memphis), Oct. 31, 1902, p. 4.

79. *Chattanooga Daily Times*, May 21, 1896, p. 6.

80. See *id.* May 21, 1896, p. 3.

81. *Chattanooga Press*, May 29, 1896, p. 6.

82. *Maryville Times*, June 4, 1896, p. 2.

83. *Chattanooga Press*, May 29, 1896, p. 6.

84. *Knoxville Journal* quoted in *Nashville Banner*, May 27, 1896, p. 4.

85. *Buffalo Commercial*, Dec. 16, 1895, p. 1.

86. *Knoxville Sentinel*, May 21, 1896, p. 1.

87. *Journal and Tribune* (Knoxville), Mar. 13, 1896, p. 2; *Commercial Appeal* (Memphis), Mar. 13, 1896, p. 1; *The Tennessean*, Mar. 13, 1896, p. 8.

88. *Chattanooga Times*, Mar. 4, 1897, p. 8.

89. *Id.* Mar. 3, 1897, p. 5; *Commercial Appeal* (Memphis), Nov. 18, 1897 p. 1; *Times-Democrat* (New Orleans), Nov. 19, 1897, p. 7.

90. See *Chattanooga News*, July 21, 1915, p. 5.

91. *The Tennessean*, Jan. 3, 1898, p. 4.

92. Crutchfield at 116.

93. *Id.* at 169; *Knoxville Sentinel*, Jan. 24, 1906, p. 4; *Biographical Directory of the United States Executive Branch 370* (Robert Sobel, ed. 1977).

94. *Knoxville Sentinel*, Aug. 10, 1900, p. 7.

95. *Chattanooga News*, Oct. 13, 1917, p. 12; Green at 227.

96. *Chattanooga Times*, Feb. 19, 1902, p. 6.

97. See *Chattanooga News*, Sept. 20, 1913, p. 4.

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