

**MY HUSBAND RECENTLY PASSED AWAY,
SO WHAT ARE MY OBLIGATIONS UNDER OUR JOINT LIVING TRUST?**

By Braun Siler Kruzel PC

A common scenario in estate planning occurs when a Husband and Wife set up a joint living trust. To illustrate, assume the Husband and Wife have \$4 million in combined assets, all held in the joint trust. Under the terms of the trust, upon the first spouse's death, one-half of the property (or \$2 million) is to be funded into an irrevocable sub-trust under which the survivor is the sole beneficiary. Upon the surviving spouse's death, the balance of the sub-trust passes to children of the first spouse. The surviving spouse is now faced with the following situation.

It is now 2017, and Husband dies. Current estate and gift tax law provides that the Husband and the Wife each have a \$5.49 million federal estate and gift tax exemption. Wife now asks her financial advisors, her accountant, and her insurance agent whether she still needs to fund the \$2 million sub-trust (for purposes of this discussion, identified as "Husband's Trust"). There is arguably no "probate" estate or no "taxable" estate, but work still needs to be done with the trust. Wife wonders if funding the sub-trust is necessary because the estate and gift tax exemption has risen to \$5.49 million. Notwithstanding recent changes in the federal estate and gift tax, there are several reasons why she should still fund Husband's Trust.

1. **Ensure Disbursement to Husband's Named Beneficiaries.** By funding Husband's Trust, this ensures that upon Wife's death, the balance of Husband's Trust passes to Husband's beneficiaries. If all of the property is retained by Wife, Wife can pass all property to family members, friends, a new boyfriend, a new husband, or charities of her choice. In taking such action, not only would she be disregarding Husband's wishes, she would be establishing the basis for a fiduciary dispute between herself and her Husband's beneficiaries.
2. **Provide Creditor Protection for Wife.** If Wife funds Husband's Trust, the \$2 million designated to that sub-trust is potentially titled in a creditor protected sub-trust set up for Wife's benefit. What if Wife faces either a catastrophic health care claim or happens to have had a bad car accident creating several million dollars in liability? If the \$2 million passes into a properly drafted Husband's Trust for her benefit, she is a discretionary beneficiary of Husband's Trust for her lifetime. As a result, she maintains the benefit of the assets in Husband's Trust but none of Wife's creditors can attack the principal \$2 million held in Husband's Trust.
3. **Establish a Step-up in Income Tax Basis.** When funding Husband's Trust, Wife will also go through the process of valuing all of the assets in her and her Husband's estate for both estate and income tax purposes. Assuming the entire \$4 million was community property, Wife would receive a full step-up in income tax basis in all assets, including Wife's \$2 million share of the trust. Therefore, if Wife values all the assets and splits the assets between the two sub-trusts, Wife will then receive a step-up in income tax basis, and potentially eliminate thousands of dollars of capital gains tax.
4. **Eliminate Estate Tax.** By funding the \$2 million into Husband's Trust, that \$2 million in assets, plus any appreciation, will be available for Wife's benefit but will not be in Wife's taxable estate. In 2012, planners were advising clients that Congress would reduce the estate and gift tax credit to \$1 million. If the estate and gift tax credit was ever reduced in the future, any amount that passed into Husband's Trust, plus any appreciation on that property, will be out of Wife's taxable estate forever.

5. **Establish Protection for Children.** An element of Husband's Trust may provide (when drafted properly) that Wife receive full use of the property for her lifetime, but upon her death, the balance will be split into separate shares for his two children. These two shares may be placed into generation-skipping tax ("GST") exempt trusts for Husband's two children. In that scenario, the children will then not only have estate tax protection, but may also achieve generation-skipping tax protection, creditor protection, and protection from disgruntled ex-spouses of the two children.

6. **Permit Wife to Use Husband's Unused Estate Tax Credit.** In our example, Husband only had a \$2 million taxable estate. However, in valuing all of Husband's assets, Husband has an available estate and gift tax credit of \$5.49 million. Wife, as the surviving spouse, may choose to file an estate tax return and claim Husband's unused \$3.49 million ($\$5.49M - \$2M = \$3.49M$) estate tax credit. This is what is called the "decedent spouse's unused exclusion" (the "DSUE"). By claiming her Husband's DSUE, Wife may have an additional \$3.49 million in estate tax credit available to her in addition to her own \$5.49 million estate tax credit. The use of the DSUE can be quite valuable, especially if Wife remarries and her new spouse has a large taxable estate. The new spouse would like to have access to Wife's DSUE, and may even be willing to compensate Wife for the use of her DSUE.

7. **State Estate Tax.** Wife should be aware that although the federal estate and gift tax exemption is presently \$5.49 million, and although Arizona law does not presently have an estate tax, several states have state estate or inheritance taxes. Further, most of those states have exemptions considerably lower than \$5.49 million. Therefore, depending upon where Wife is living when she dies, if the entire \$4 million passes to Wife, she may unwittingly trigger considerable state estate tax when she dies.

8. **Fulfill Husband's Testamentary Wishes.** While all of the above points are important reasons to complete the sub-trust funding, the primary reason to fund Husband's Trust is that both Husband and Wife agreed when they created their Trust to fund Husband's Trust. In making this agreement, Husband wanted to be assured that his property would pass to his children upon death. He also wanted to protect his share of the property from Wife's creditors. It was clearly his intent and desire to protect and preserve his share of their property, and to do so through the tools and protections offered by the Husband's Trust.

Unfortunately, upon the death of a spouse, many surviving spouses choose to do nothing. In the foregoing example, if Wife, as surviving spouse, chooses to do nothing, Wife can open herself up to breach of fiduciary claims from Husband's children. Even if these are also Wife's children, what happens if Wife remarries and passes everything to a new spouse? As a result, Husband's surviving children then make a claim against Wife's estate since she chose to pass everything to her new spouse, rather than to Husband's surviving children as required under the joint trust.

We advise all our clients who have a joint trust that requires them to fund a \$1 million, \$2 million, or \$3 million trust upon their spouse's death against simply choosing to do nothing. In our example above, rather than do nothing, our advice is that Wife must fund and operate Husband's Trust. As an alternative, if the entire family and Wife insist that she will not fund Husband's Trust, all family members should enter into an agreement acknowledging their understanding and agreement that they are waiving any rights to Husband's Trust and all of the other benefits listed above. Under the terms of that agreement, all family members would need to acknowledge that: i) they are relieving Wife of any fiduciary obligation; ii) all property passes to Wife outright; and iii) all property will not be held as provided in Husband's Trust. Anything less than the execution of a complete this agreement leaves Wife's estate open to the claims of Husband's family, and more often than not, results in unnecessary family discord.