

How Credit Shelter Trusts Can Cure the Ills of Jointly Held Property

There are many benefits to holding property jointly, particularly with a spouse; however, the detriments often outweigh the benefits. There are two forms of joint ownership. The first, joint tenancies, has rights of survivorship, but the second, tenancies in common, does not. A right of survivorship means that the surviving joint owner becomes the sole owner of the property upon the death of the deceased joint owner. Only joint tenancies will be addressed in this article.

Joint ownership is simple and convenient. For example, either party can deposit or withdraw funds from a joint account without the consent of the other joint owner. At the death of the first owner, the surviving joint owner becomes the sole owner by operation of law. In other words, the probate process is completely avoided.

At the same time, joint ownership has its detriments. Because both parties have full access to the joint property, the property is subject to the claims of the creditors of both owners. For example, suppose that Mr. Smith decides to “put his son’s name on the deed” of his home (convert the ownership to a joint tenancy) and the son is successfully sued. The plaintiff in the lawsuit can take the property and leave Mr. Smith homeless.

In the case of jointly held property between spouses, the property avoids probate upon the death of the first joint owner but is subject to the probate process upon the death of the surviving joint owner; thus, the probate process is only delayed. Additionally, and the largest potential detriment to owning property jointly with a spouse, is the failure to utilize the unified credit (or so-called exemption) of the first decedent.

Trust Dynamics

Suppose that Mr. and Mrs. Smith jointly own all of their property which has a total fair market value of \$2.0 million. If Mr. Smith dies, his wife becomes the sole owner of all of the property and the probate process is avoided completely. Upon Mrs. Smith’s death, the entire amount is subject to the probate process. Moreover, Mrs. Smith’s exemption from estate taxes of \$1.0 million (assuming 2003 as her year of death), subjects \$1.0 million to estate tax resulting in a tax of approximately \$425,000.

Conversely, with the use of a credit shelter trust, the Smiths can completely avoid estate taxes and leave all \$2.0 million of their property to their heirs. While both of the parties are alive, half of the jointly held property is transferred to each of Mr. and Mrs. Smith, individually (or to a revocable trust for each). Upon the death of Mr. Smith, Mr. Smith’s trust becomes (to the extent it is not already) the owner of the property. There is no estate tax because of Mr.

Smith's \$1.0 million exemption. Upon Mrs. Smith's subsequent death, her trust becomes (again, to the extent it is not already) the owner of all of her property and no estate tax is paid because of her exemption.

The credit shelter trust, also called a by-pass trust, a family trust and a "B" trust, is an irrevocable trust created upon an individual's death either in accordance with the decedent's will or, much more commonly, in accordance with a revocable trust created by the decedent during his or her lifetime. The trust commonly permits and may even require distributions to the surviving spouse, children and grandchildren of the decedent.

Plusses and Minuses

In addition to the substantial estate tax benefit that can be derived from such trusts, the trusts can be drafted to avoid the claims of creditors of most (and often all) of the beneficiaries and can permit distributions for any number of reasons over long periods of time. Often such trusts are used to primarily benefit the surviving spouse and then to provide for the education of the children and/or grandchildren.

A common technique is or a professional disinterested trustee to serve with a surviving spouse and provide assistance with the investment of the trust property and the tax implications of the same. Utilizing a professional disinterested trustee can compensate for a lack of investment experience (or interest) in either a surviving spouse or a child and also ensure that the decedent's estate planning objectives with respect to the trust property are honored long after that person's death, thereby protecting the family members from others and themselves.

The largest detriment to the use of a credit shelter trust is the loss of control. In the jointly held property situation, the surviving spouse has complete control over all of the property after the first death. In contrast, after a decedent's property transfers to a credit shelter trust, the terms of the trust control the property. The loss of control can be substantially mitigated by making the surviving spouse a Trustee and limiting the permissible distributions. Conversely, in many cases, such as a second marriage, restricting the control of the surviving spouse can ensure that the property is ultimately distributed in the manner prescribed by the deceased spouse.

Credit shelter trusts are very commonly used in estate planning; however, no one solution works in all cases. The type, composition and amount of property must be evaluated in consideration of a family's overall estate planning objectives to determine the "best" technique.

The author of this article, Joseph G. Imbriani, Esq., CPA/PFS, practices in the areas of taxation and estate planning and is a partner of the Boston law firm of Taylor, Ganson & Perrin, LLP.

