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MARRIED COUPLES: JOINT OR SEPARATE TRUSTS?

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Estate Planning Red Flag

You've left specific assets to specific heirs

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Married couples: Joint or separate trusts?

Revocable trusts are a key component of many estate plans. Among other things, these trusts allow you to minimize probate expenses, keep your financial affairs private and provide for the management of your assets in the event you become incapacitated. They also offer flexibility: You're free to amend the terms of the trust or even revoke it altogether at any time.

For married couples, one important decision is whether to use a joint trust or separate trusts. The right choice depends on their financial and family circumstances, applicable state law and other factors, so couples should discuss their options with their advisor. Here are some factors to consider.

Ease of administration

Provided each spouse is comfortable with the other spouse inheriting all of their combined assets, a joint trust can be less complex to set up and administer than separate trusts. Funding the trust is a simple matter of transferring assets into it and avoids the need to divide assets between two separate trusts.

In addition, during their lifetimes, each spouse has equal control over the trust's assets, which can make it simpler to manage and to conduct transactions involving the assets. On the other hand, for spouses who aren't comfortable sharing control of their combined assets, separate trusts may be the way to go.

Another potential advantage of joint trusts is that they simplify real estate transactions. For example, if a couple's home is held in a joint trust, it's easy for a surviving spouse to sell the home. However, if the home is titled in the trust of the deceased spouse or is split between their separate trusts (as tenants in common), selling the home may be more challenging.

Family circumstances

If one or both spouses want to ensure that a portion of their assets go to someone other than their surviving spouse, separate trusts may be a better option. For example, if a spouse has children from a previous marriage, a separate trust makes it possible to provide income to the surviving spouse for life, while preserving the remaining funds for his or her children.

Separate trusts may also be preferable if one or both spouses are uncomfortable handing over complete control of their combined assets to the other spouse. For example, if one of them isn't good at managing money, the other spouse may prefer to use a separate trust and appoint an independent trustee to manage the trust assets and control distributions.

Asset protection

If shielding assets from creditors is a concern, separate trusts usually offer greater protection. With a joint trust, if a creditor obtains a judgment against one spouse, all of the trust assets may be at risk.

The high tax cost of irrevocable trusts

One disadvantage of separate revocable trusts is that when one spouse dies, his or her trust becomes irrevocable, potentially triggering significantly higher income taxes. Irrevocable trusts (other than grantor trusts, which aren't relevant here) are subject to a high rate of tax on their undistributed income.

In 2024, for example, the federal income tax brackets for trusts are as follows:

Taxable income	Tax
$0–$3,100	10%
$3,101–$11,150	$310 + 24% of the amount over $3,100
$11,151–$15,200	$2,242 + 35% of the amount over $11,150
$15,201 +	$3,659.50 + 37% of the amount over $15,200

In contrast, the 24%, 35% and 37% tax brackets for individuals (other than joint filers, for whom the amounts are higher) don't kick in until taxable income reaches $100,525, $243,725 and $609,350, respectively. So, unless the trust distributes all or most of its income each year, a significant portion of its earnings may be eroded by income taxes.

A spouse's separate trust is generally protected from the other spouse's creditors.

Also, when one spouse dies, his or her trust becomes irrevocable, making it more difficult for creditors of either spouse to reach the trust assets. Keep in mind that the degree of asset protection a trust provides depends on the type of debt involved, applicable state law, the existence of a prenuptial agreement and other factors.

Tax planning

For most couples today, federal gift and estate taxes aren't a concern. This is because they enjoy a combined gift and estate tax exemption of more than $27 million in 2024 (scheduled to drop to around $14 million in 2026).

However, if a couple's wealth exceeds the exemption amount, or if they live in a state where an estate or inheritance tax kicks in at lower asset levels, separate trusts offer greater opportunities to avoid or minimize these taxes. For example, some states have exemption amounts as low as $1 million or $2 million. In these states, separate trusts can be used to make the most of each spouse's exemption amount and minimize exposure to death taxes.

It's also important to consider income tax. When one spouse dies, his or her trust becomes irrevocable. That means filing tax returns for the trust each year and, to the extent trust income is accumulated in the trust, paying tax at significantly higher trust tax rates. (See "The high tax cost of irrevocable trusts" above).

A joint trust remains revocable after the first spouse's death (it doesn't become irrevocable until both spouses have passed). In this case, income is taxed to the surviving spouse at his or her individual tax rate.

Review the pros and cons

Joint and separate trusts each have advantages and disadvantages. To determine which is right for you, review the pros and cons with your advisor in light of your particular circumstances. ■

Beware of tax traps when estate planning for non-U.S. citizens

If you're not a U.S. citizen, or if you're married to a noncitizen, estate planning can be a bit more complicated. To avoid costly tax traps, it's important to have a basic understanding of how the U.S. gift and estate tax laws apply to noncitizens.

A question of domicile

Noncitizens can become subject to U.S. gift and estate taxes if they're domiciled in the United States. Under IRS guidelines, an individual becomes domiciled in a country "by living there, for even a brief period of time, with no definite present intention of later removing therefrom."

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To determine a person's "present intention," the IRS considers a number of factors, such as the amount of time the person spends in the United States; their green card or visa status; the location of their business interests and residences; the location of their health care providers, jobs, places of worship and community ties; the place where their vehicles are registered and where they're licensed to drive; the place where they're registered to vote; and the domiciles of their friends and family members.

Noncitizens who are deemed to be domiciled in the United States are subject to U.S. gift and estate taxes on their worldwide assets, much like U.S. citizens. And, like U.S. citizens, they're eligible for the federal gift and estate tax exemption ($13.61 million for 2024) and the annual gift tax exclusion ($18,000 per recipient for 2024).

A significant difference between U.S. citizens and noncitizens, and a potential tax trap for the unwary, is that the marital deduction isn't available for transfers to noncitizens. Ordinarily, married couples can transfer an unlimited amount of assets between each other — during their lifetimes or at death — without triggering gift or estate taxes. But estate planning strategies that rely on the marital deduction may not be available to noncitizen domiciliaries.

There are other options, however. For example, a spouse can:

- Make tax-free transfers to his or her noncitizen spouse up to the transferor's unused gift and estate tax exemption.
- Make annual exclusion gifts. The annual exclusion for gifts to a noncitizen spouse is $185,000 for 2024.
- Transfer assets to a qualified domestic trust (QDOT) that meets certain requirements. Amounts transferred at death to a QDOT for the benefit of a noncitizen spouse qualify for the marital deduction. However, estate tax is merely deferred rather than eliminated. The surviving spouse can withdraw income from the trust, but any distributions of principal immediately become subject to estate tax. And the entire amount becomes taxable when the surviving spouse dies (unless he or she becomes a U.S. citizen).

Tax trap for nonresident aliens

A person who's neither a U.S. citizen nor a U.S. domiciliary — that is, a "nonresident alien" — is subject to U.S. gift and estate taxes only on assets that are "situated" in the United States. Examples include U.S. real estate and personal property located in the United States (with certain exceptions). Intangible property — such as corporate stock, bonds or promissory notes — is deemed to be situated in the United States for estate tax purposes (but typically not for gift tax purposes) if it's issued by a domestic corporation or by a U.S. citizen or the U.S. government.

Here's where the potential tax trap comes into play: The exemption amount for U.S.-situated assets owned by nonresident aliens is only $60,000, compared with $13.61 million for U.S. citizens or domiciliaries. Depending on the value of a person's property in the United States, this can result in significant gift and estate taxes.

There may be strategies for avoiding these taxes, such as holding the assets through a properly structured and operated foreign corporation. Also, in some cases, tax treaties between the United States and a nonresident alien's country of citizenship may provide some relief.

Steer clear of the traps

If you or your spouse is a noncitizen, talk to your advisor about the potential estate planning ramifications. He or she can help you develop strategies for steering clear of the traps and minimizing any adverse tax consequences. ∎

Your beneficiary designations may be obsolete: Review and update as needed

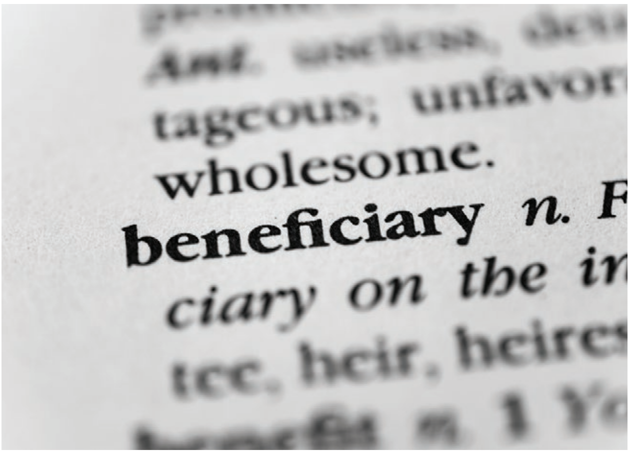
The chances are good that you've made beneficiary designations in your estate plan. Indeed, for most people, a substantial amount of wealth is transferred to their loved ones that way.

Making beneficiary designations is an excellent tool for transferring assets that aren't subject to probate, including IRAs and certain employer-sponsored retirement accounts, life insurance policies, and some bank or brokerage accounts. Still, it's important to occasionally revisit those decisions. Over time, these beneficiary designations may become inappropriate or obsolete because of changes in life circumstances. Making changes may be required.

Follow best practices and avoid pitfalls

As you conduct your review of your current beneficiaries, here are some points to consider:

Name a primary beneficiary and at least one contingent beneficiary. Without a contingent beneficiary for an asset, if the primary beneficiary dies before you do, the asset will end up in your general estate and may not be distributed as you intended. In addition, certain assets, including retirement accounts, offer some protection against creditors,



and those protections would be lost if the assets are transferred to your estate. To ensure that you control the ultimate disposition of your wealth and protect that wealth from creditors, it's important to name both primary and contingent beneficiaries and to avoid naming your estate as a beneficiary.

Update beneficiaries to reflect changing circumstances. Designating a beneficiary isn't a "set it and forget it" activity. Failure to update these designations to reflect changing circumstances creates a risk that you will inadvertently leave assets to someone you didn't intend to benefit, such as an ex-spouse.

It's also important to update your designation if the primary beneficiary dies, especially if there's no contingent beneficiary or if the contingent beneficiary is a minor. Suppose, for example, that you name your spouse as primary beneficiary of a life insurance policy and name your minor child as the contingent. If your spouse dies while your child is still a minor, it's advisable to name a new primary beneficiary to avoid the complications associated with leaving assets to a minor (court-appointed guardianship, etc.).

Consider the impact on government benefits. If a loved one depends on Medicaid or other government benefits (a disabled child, for example), naming that person as primary beneficiary of a retirement account or other asset may render him or her ineligible for those benefits. A better approach may be to establish a special needs trust for your loved one and name the trust as beneficiary.

Keep an eye on tax developments. Changing tax laws can easily derail your estate plan if you fail to update your plan accordingly. For instance, the SECURE Act sounded the death knell for the "stretch" IRA. Previously, when you left an IRA to a child or other beneficiary (either outright or in a specially designed trust), distributions could be stretched out over the beneficiary's life expectancy, maximizing tax-deferred savings. Today, most non-spousal beneficiaries of IRAs must distribute the funds within 10 years after the owner's death.

In light of this change, review the designated beneficiaries for your IRAs and other retirement accounts, evaluate the impact of the SECURE Act on these beneficiaries, and weigh your options. For example, you might consider naming different individual beneficiaries or leaving IRAs to a charitable remainder trust or other vehicle that mimics the benefits of a stretch IRA.

Review your entire estate plan

Bear in mind that major life changes can affect other aspects of your estate plan — not just beneficiary designations. Your estate planning advisor can help point out areas of your plan that may require revisions after such a change.

ESTATE PLANNING RED FLAG

You've left specific assets to specific heirs

When creating your estate plan, it may be tempting to leave specific assets to specific loved ones. Perhaps you want your oldest child to have the family home or a stock that has sentimental — as well as financial — value. Unfortunately, by doing so you risk inadvertently disinheriting other family members, even if you've gone out of your way to ensure that they're treated fairly. Consider the following example:

Lucy has three children, Susan, Peter and Emma. At the time she prepares her estate plan, Lucy has three main assets: company stock valued at $1 million, a mutual fund with a $1 million balance and a $1 million life insurance policy. She leaves the stock to Susan, the mutual fund to Peter and appoints Emma the beneficiary of the life insurance policy. When Lucy dies 15 years later, things have changed considerably. The stock's value has dropped to $500,000, the mutual fund has grown to $2.5 million and she has allowed the life insurance policy to lapse.

The result: Although Lucy intended to treat her children equally, Peter ends up with the bulk of her estate, Susan's inheritance is significantly smaller than expected and Emma is disinherited altogether. To avoid unintended results like this, consider distributing your wealth among your heirs based on percentages or dollar values rather than providing for specific assets to go to specific people.

However, if it's important to you that certain heirs receive certain assets, there may be planning strategies you can use to ensure that your heirs are treated fairly. Returning to the previous example, Lucy could've provided for her wealth to be divided equally among her children, with Susan receiving the stock (valued at fair market value) as part of her share. That way, Susan would have received the stock plus $500,000 of the mutual fund, and Peter and Emma would each have received $1 million of the mutual fund.

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