ILLINOIS JOINT TRUST DISADVANTAGES

The "joint trust" as an estate planning tool has had mixed reviews among estate planning practitioners. In community property states, it is the preferred instrument. In common law states, such as Illinois, it is generally considered to pose more dangers and problems than benefits.

To maximize estate tax savings, we want to make use of both of the estate tax exemptions of a husband and wife. We do this by creating a trust (sometimes called the "Family Trust" or "Credit Shelter Trust") that will shelter an amount of money at the death of the first spouse. The surviving spouse can be the trustee, have broadly defined rights to income and principal from the trust, and can even have the right to direct how the property passes at death, without having the Family Trust assets taxed at the second death. On the death of the first spouse, all property owned by that spouse receives a new income tax basis equal to the property's fair market value, as of date of death. In a joint trust, both spouses create the trust. Each spouse transfers property to the trust. Unless very careful, detailed paperwork is maintained, identifying which property was contributed by which spouse may become very difficult, if not impossible. Practically, the only way to guarantee that these records are accurate is to keep the property separately titled. This is what happens when two trusts are used.

In addition, Illinois is a common law state, where the title to property governs its ownership. If two people jointly own something, then they each have an ownership interest **in the entire property**: the survivor can't later claim that he or she owned only half of it. Unless property is separately held when contributed to a joint trust, and unless careful records are kept over the life of the joint trust, basis step-up may be challenged when the first spouse dies.

Segregation of assets is difficult with normal assets, but become especially difficult when you are dealing with contractual rights, such as life insurance. A "paper trail" should be established when the trust is funded, to show which assets came from which spouse. Ongoing accounting of the trust asset should be preserved, in order to deal with changes in investments: only assets which can be traced back to the contribution made by the first spouse to die can get the basis step-up when the first spouse dies. As an example, imagine asking a bank to retitle a certificate of deposit into a trust (i) which has a single name and date, and (ii) which names both of you as trustees, but then asking the bank somehow to designate the certificate of deposit as a "wife's trust" assets.

Without careful and complex drafting, assets contributed by the survivor may get NO BASIS STEP-UP at either death: basis step-up may not be allowed at the first to die if it cannot be shown that assets were contributed by the first decedent.. Basis step-up will **NOT** be allowed for assets at the survivor's death to the extent those assets were allocated to the Family Trust.

Creditor protection features are lost. Often, one spouse will have greater exposure to creditor's claims because of that spouse's occupation, or otherwise. Assets held in the other spouse's name (or in the other spouse's Declaration of Trust) ordinarily will not be exposed to these creditors. Assets held in a joint trust will be exposed.

Finally, the tax advantages in using a Joint Trust have been only informally approved, through two IRS Private Letter Rulings. This type of ruling is not formal precedent for anyone but the taxpayer who submitted the request for the Ruling. While there is general consensus that the result of the Rulings can be extended to other taxpayers, there is no legal precedent for doing so. In addition, the IRS can (and often does) reverse the position it has taken in a Private Letter Ruling.

Joint trusts may have a place in Illinois -- but probably is safest used in a nontaxable estate where there is absolutely no possibility of the total estate ever exceeding federal estate tax exemption.

The information presented here is based on researching IICLE materials to provide a basic understanding to the problems associated with a joint trust under Illinois law.