FINDING BASIS – IT'S NOT ALWAYS WHERE YOU THOUGHT

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OBTAINING A BASIS ADJUSTMENT IN A NON-MARITAL TRUST AT THE SURVIVING SPOUSE'S DEATH (p. 2)

There are four potential ways to achieve the basis step-up:

- Independent trustee power of distribution;
- Contingent general power of appointment;
- Trust protector with the ability to create a general power of appointment; and
- Delaware Tax Trap.

Independent Trustee Power of Distribution (pp. 2-4)

Advantages:

- Selection of Appreciated Assets;
- Retention of Depreciated Assets; and
- Simplicity

Independent Trustee Power of Distribution (pp. 3-4)

Disadvantages:

- Finding a bold independent trustee is hard;
- Timing Problems – trustee must have information on spouse's health and finances;
- Diversion to creditors; and
- Irrevocability.

Contingent Formula General Power of Appointment (p. 4)

- Give the surviving spouse a general power of appointment over that portion of the family trust that is equal to the difference between the spouse’s taxable estate and his or her applicable exclusion amount.

- This includes just enough of the family trust in the surviving spouse’s estate to obtain the maximum basis adjustment possible without incurring additional estate taxes.

Contingent Formula General Power of Appointment (pp. 8-10)

Advantages:

- Power can be limited to appreciated assets; can avoid giving a power over depreciated assets;
- The contingent formula is automatic – no one has to do anything;
- No need for data on spouse’s health and finances; and
- The Trustee need not be bold – good for the family trustee.

Contingent Formula General Power of Appointment (p. 10)

Disadvantages:

- Spouse's creditors may reach the power;
- Disclaimer funded nonmarital trust may raise problems;
- Spouse may exercise the power (solved by requiring consent of a non-adverse party); and
- Drafting complexity.

Contingent Formula General Power of Appointment -- The *Kurz* Dilemma (pp. 11-15)

Power Conditioned on Acts of Independent Significance. ***Estate of Kurz v. Comm'r*, 101 T.C. 44 (1993), *aff'd*, 68 F.3d 1027 (7th Cir. 1995).**

- Ethel Kurz, a widow, had a 5% withdrawal right over the family trust, but only after her marital trust was exhausted. Ethel was entitled to withdraw as much of the principal of the marital trust as she wished; she had only to notify the trustee in writing.
- When Ethel died, her marital trust was worth about \$3.5 million and the family trust was worth about \$3.4 million.

Estate of Kurz (cont'd)

- Ethel's Estate argued -- the marital trust was not exhausted on the date of death, so the contingency on the 5% withdrawal power was not satisfied and none of the family trust was includible in Ethel's gross estate.
- Service argued -- a power of appointment (or withdrawal) is exercisable even if there is an unsatisfied condition, if the holder of the power has the power to remove the condition. Ethel had the ability to empty the marital trust and thus to remove the condition. Therefore, 5% of the family trust is includible in Ethel's gross estate.

Estate of Kurz (cont'd)

- The Tax Court held for the government. The court held that:

  - A precondition sufficient to prevent the taxability of a general power of appointment need not be beyond the decedent's control, but it must have some significant non-tax consequence independent of the decedent's power to appoint the property; and

  - Withdrawing principal from the Marital Trust Fund had no significant non-tax consequence independent of Ethel's power to withdraw principal from the Family Trust. Thus, it is an illusory condition that will not shield the power of appointment from taxation.

Estate of Kurz (cont'd)

The Seventh Circuit affirmed, noting that the Commissioner's argument raises a question.

What if the withdrawal power were conditioned upon Ethel's losing 20 pounds or achieving a chess rating of 1600 or surviving all of her children?

These are theoretically within Ethel's control -- she could go on a crash diet, study the games of Gary Kasparov, or murder her children. Yet, these decisions have no financial implications apart from the withdrawal power.

The Tax Court rightly rejected control as a standard.

Estate of Kurz (cont'd)

- Can the holder of the formula conditional general power of appointment alter the size of his or her taxable estate and the amount of the power of appointment, by acts lacking independent significance?
- A surviving spouse could make testamentary transfers that qualify for the unlimited estate tax marital or charitable deduction or could deductible debts that are deductible by the estate.
- These all seem to involve acts of independent significance, but there are very few precedents on what is an act of independent significance for estate tax purposes. These involve marriage, having children, and quitting one's job.

Estate of Kurz (cont'd)

- Formula clause could base size of general power of appointment on size of decedent's adjusted gross estate, calculated before the estate tax marital and charitable deductions and the deduction for debts of the estate.
- This produces a smaller general power than would be optimal to include enough assets in the surviving spouse's gross estate to raise the taxable estate to the applicable exclusion amount.

Drafting the Formula Power of Appointment (pp. 15-27)

- Simple, moderate, or complicated. Your choice.
- If you have a good fiduciary, simple works fine.
- Otherwise, choose moderate.
- Avoid complicated. It is not really that much better (and no trustee or beneficiary will understand it).

Independent Person’s Power to Grant a General Power of Appointment (pp. 27-32)

Authorize a trust protector or independent trustee to grant the surviving spouse a general power of appointment in whatever amount and over whichever assets the trust protector or trustee deems appropriate.

Independent Person’s Power to Grant a General Power of Appointment (cont’d) (p. 28)

Advantages:

- Select just appreciated assets; retain depreciated assets;
- Simplicity; and
- Revocability and amendability of the grant.

Independent Person’s Power to Grant a General Power of Appointment (cont’d) (pp. 28-29)

Disadvantages:

- It requires a bold independent trustee, and they can be hard to find;
- Timing problems;
- Creditors;
- Disclaimer-funded nonmarital trusts; and
- Is the power really general?

The Delaware Tax Trap (pp. 30-33)

- Section 2041(a)(3) states that a limited power of appointment is taxed as a general power, if:

  - It is exercised in further trust;

  - The new trust creates a new power of appointment; and

  - Doing so postpones the vesting or suspends the absolute ownership or power of alienation of the appointed property, for a period ascertainable without regard to the date of the creation of the first power.

The Delaware Tax Trap (cont’d)

- At common law, exercising a limited power of appointment does not usually start a new perpetuities period.
- Delaware law provided the only broad exception to this rule; there, any exercise of a limited power of appointment started a new perpetuities period.
- In other states, you can start a new perpetuities period by giving a beneficiary a presently-exercisable general power to appoint the assets to himself or herself.

The Delaware Tax Trap (cont'd) (pp. 34-35)

Advantages:

- It places the entire responsibility on the surviving spouse – it does not require action by the fiduciary or attorney;
- The fiduciary need not obtain personal information about the surviving spouse;
- The surviving spouse has a more difficult time diverting assets;
- It may provide superior creditor protection;
- It can be used even when there was no advanced planning for basis, as long as the surviving spouse already has or can be given a limited testamentary power of appointment;
- Jonathan Blattmachr absolutely loves it.

The Delaware Tax Trap (cont’d) (pp. 35-36)

Disadvantages:

- It is really, really complicated;
- It is not automatic – the surviving spouse must act;
- It may be difficult to exercise in a state that has no rule against perpetuities; and
- Exercising it by giving a beneficiary a presently-exercisable general power of invasion, though easy to do, exposes the trust assets to estate taxes at the beneficiary’s death and to claims of the beneficiary’s creditors.

The Delaware Tax Trap -- States That Have No Rule Against Perpetuities (pp. 36-44)

Springing the Trap is particularly complicated in a state that has abolished the rule against perpetuities, either for all trusts or for electing trusts. This includes at least 18 states, including Missouri and Virginia.

The Delaware Tax Trap -- States That Have No Rule Against Perpetuities (cont'd) (pp. 37-44)

Murphy v. Comm'r, 71 T.C. 671 (1979), *acq. recommended* A.O.D. 1979-87, 1979 WL 53162 (May 30, 1979), *acq*. 1979-2 C.B. 1

- Tax Court held that the Delaware Tax Trap was available in Wisconsin – a state that had revoked the rule against perpetuities with respect to vesting and ownership but preserved it with respect to alienation.
- An interest was void in Wisconsin only if it suspended the power of alienation for a period longer than a life or lives in being, plus 30 years.
- The power of alienation was not suspended if the trustee had the power to sell the assets.

The Delaware Tax Trap -- States That Have No Rule Against Perpetuities (cont'd)

- The estate argued that the Trap did not apply because, while the exercise of a limited power of appointment did extend the term of the trust with respect to alienation, it did not do so with respect to vesting or ownership.
- The IRS argued that the trap is independent of state law and applies when the right to vesting, distribution, or alienation is deferred.
- The court held for the estate, noting that state law controlled the determination of whether the period of the Rule Against Perpetuities had been validly extended.

The Delaware Tax Trap -- States That Have No Rule Against Perpetuities (cont'd)

- The IRS acquiesced, noting that "the Tax Court's holding is reasonable, and an appeal, (while possibly warranted based on the legislative history), would be inappropriate in light of the specific wording of the regulation and the last portion of section 2041(a)(3)." A.O.D. 1979-87, 1979 WL 53162 (May 30, 1979).

The Delaware Tax Trap -- States That Have No Rule Against Perpetuities (cont'd)

Therefore:

- If a perpetual trust creates a limited power of appointment that is exercised to create another perpetual trust -- the Trap is not sprung because the perpetuities period is not extended.

- If a trust is perpetual as to vesting and ownership but of limited duration as to the power of alienation (the trustee has the power of sale during a period limited by the Rule Against Perpetuities), and a limited power of appointment is exercised to create a trust that is perpetual as to vesting and ownership but not as to the power of alienation, and a new power of sale is created starting a new perpetuities period, then the Trap is sprung.

Asset Protection Concerns for Basis Adjustment Mechanisms (pp 44-46)

- Actual distribution of assets to surviving spouse – all creditor protection is lost.
- Grant a general power of appointment to the surviving spouse – VAMS 456.1105 states that the appointable assets are subject to the claims of the spouse’s creditors only if the spouse’s other assets are insufficient to meet claims.
- Formula general power of appointment should be the same as an independently granted power of appointment.
- Delaware Tax Trap should not be exposed to claims of spouse’s creditors, because spouse has only a limited power of appointment.

THE POWER OF APPOINTMENT SUPPORT TRUST (“POAST”) -- TAX SHELTER LEASING OF THE ELDERLY? (pp. 46)

- Tactless truth -- The death of a parent, grandparent, or other older relation or friend is a sad enough event without also wasting the opportunity for a significant basis increase.
- If such an older person (an “upstream person”) has an excess of applicable exclusion amount, his or her death is an opportunity to obtain an additional basis increase.

Outright Upstream Gifts (p. 47)

One can, of course, give an upstream person sufficient appreciated assets to take advantage of his or her unused applicable exclusion amount.

This is a relatively simple way to obtain basis, but it presents several problems.

- Poor use of donor’s applicable exclusion amount;
- Possible diversion of property by the donee;
- Risk of access by donee’s creditors and spouse; andf
- Donee dies within one year and property passes back to donor or donor’s spouse.

The Power of Appointment Support Trust (POAST) (pp. 48-74)

The power of appointment support trust involves the following:

- A transfer of property to an irrevocable trust for donees;
- Trust beneficiaries may include (or even be limited to) the donor’s spouse;
- Trust must give a general power of appointment over appreciated trust assets to one or more upstream persons.

The POAST (cont'd) (pp. 48-49)

- If the donor or the donor's spouse is a beneficiary, the transfer to the POAST must be a completed gift to obtain a basis increase.
- The holder of the general power may be naked (figuratively). The estate tax law does not require the holder of a general power of appointment to have any other interest in the trust. However, case law suggests that it would be better if the holder has some other interest in the trust.
- The holder need not be competent to exercise the power.\
- The holder need not know of the power but must at least know of the trust and that he or she is a beneficiary. *Estate of Freeman v. Comm'r*, 67 T.C. 202 (1976).

The POAST (cont'd) (pp. 55-56)

How to reduce the diversion of assets by the powerholder's exercise.

- Require that the power be exercised only with the consent of a nonadverse party. The problem with this approach is finding a nonadverse party who is willing to risk being sued by an unhappy powerholder or appointee is not always easy.
    - An independent trustee can be the nonadverse party and can defend any such suit from the trust funds.
    - That one ornery relative.
    - A local court.

The POAST (cont'd)

- Also, the consent of a nonadverse party could be required only where the holder attempts to exercise the power in favor of someone other than the donor or the natural objects of the donor's bounty.

2. Allow the powerholder to appoint only to the creditors of his or her estate. This still creates a general power of appointment.

   - Of course, the powerholder can then borrow money, spend or give it however he or she pleases, and then appoint the money to the lender, who is now a creditor of the holder's estate.

The POAST (cont'd)

3. Require that the powerholder must be solvent in order to exercise the power.
   - If the powerholder is not solvent at death, however, there is no general power of appointment.
   - This makes no sense, since an insolvent person likely has the most available applicable exclusion amount and basis increase.
4. Just be very careful selecting the powerholder and to find one who has few debts and is unlikely to incur many.
   - If you cannot trust the powerholder not to become indebteded, find another powerholder or do not do the transaction.

The POAST (cont’d)

5. Use a limited power of appointment and the Delaware Tax Trap.

The POAST -- GST Tax Issues (pp. 61-63)

An upstream general power of appointment need not cause GST tax problems, but it does change the GST status of the trust and it does require that the upstream person holding the general power of appointment allocate or be deemed to have allocated GST exemption to the trust either during lifetime or at his or her death.

- The upstream person becomes the new transferor.
- If the grantor allocated GST exemption, that allocation may be wasted.

POAST -- Death of Upstream Powerholder within One Year of Gift to Trust – Section 1014(e) (pp. 65-68)

- If the powerholder dies within one year of the trust's funding, a step up in basis should not be denied under Section 1014(e), even if the same assets return to the donor by appointment or in default of a valid appointment.
- Section 1014(e)(1) denies a basis adjustment for "appreciated property . . . acquired by the decedent by gift during the 1-year period ending on the date of the decedent's death. . . ."
- The grant of a general power of appointment is not a transfer of property; it is a transfer of the ability to dispose of property that the transferee (powerholder) does not possess.

POAST -- Section 1014(e) (cont'd)

- The grant of a general power of appointment is not a transfer of property; it is a transfer of the ability to dispose of property that the transferee (powerholder) does not possess.
- Always caution the client in writing that there is a chance that this type of trust will not provide the desired basis adjustment if the powerholder dies within one year.

The POAST and Grantor Trust Status (pp. 68-69)

- The grantor cannot own any portion of the trust attributable to a transfer by someone else, unless the grantor holds a withdrawal power described in Section 678.
- The death of the powerholder constitutes a constructive addition to the trust for grantor trust purposes **only if** the powerholder exercises the power in favor of the trust; the lapse of the power does not constitute a constructive addition to the trust. See Reg. §§ 1.671-2(e)(5), 167.1-2(e)(6), Ex. 9.

The POAST – Can the Grantor be a Beneficiary of the Appointed Funds? (pp. 69-72)

- A grantor who retains beneficial enjoyment or the power to alter beneficial enjoyment of a trust fund may have the trust assets included in his or her gross estate under Sections 2036 or 2038.
- The law is unclear, but there is a good chance that the same result occurs if an upstream powerholder exercises his or her general power of appointment in further trust for the grantor's benefit.
- Section 2036 does not apply because the grantor's interest is not "retained."

The POAST – Can the Grantor be a Beneficiary of the Appointed Funds? (cont'd)

- On its face, Section 2038(a)(1) should apply if the upstream powerholder appoints the subject assets in further trust for the beneficial enjoyment of the original grantor or for the enjoyment of others in the grantor's discretion. See *Seasongood v. United States*, 331 F. Supp. 486 (S.D. Ohio 1971).
- A grantor's right to distribute trust assets subject to an external ascertainable standard, however, does not fall under Section 2038(a)(1). *Estate of Ford v. Comm'r*, 53 T.C. 114 (1969), *acq. in part, nonacq. in part recommended*, AOD, 1970 WL 22802 (May 13, 1970), 1978 WL 194691 (Dec. 31, 1978), *aff'd per curiam,* 450 F.2d 878 (2d Cir. 1971).

POST-FORMATION TECHNIQUES TO CREATE BASIS IN AN IRREVOCABLE TRUST AT THE GRANTOR’S DEATH (p. 75)

- Recent increases in the applicable exclusion amount leave many grantors of irrevocable trusts with an excess of applicable exclusion amount, so that their prior gifts to irrevocable trusts will now provide little or no estate tax savings.
- Such grantors may wish to force their irrevocable trusts to be included in the grantor’s gross estate, either entirely or in part, to take advantage of the basis adjustment at death.

POST-FORMATION TECHNIQUES TO CREATE BASIS IN AN IRREVOCABLE TRUST (cont'd) (pp. 75-81)

- Option 1. Mess up the administration or distributions so that the grantor appears to have retained a right to receive or control beneficial enjoyment. Unfortunately, this does not work. The taxpayer cannot argue substance over form, because the taxpayer selects the form of the transaction and cannot thereafter challenge it.
- Option 2. Modify the trust to give the grantor the beneficial enjoyment. This does not trigger Section 2036, because the interest is not retained. It does not trigger Section 2038, because that section has been held to apply only *"where the transferor-decedent himself sets the machinery in motion that purposefully allows fiduciary powers over the property interest to subsequently return to him." Estate of Skifter v. Comm'r*.

POST-FORMATION TECHNIQUES TO CREATE BASIS IN AN IRREVOCABLE TRUST (cont'd) (pp. 83-84)

- Solution: Amend the trust to grant the grantor a general power of appointment over all or part of the trust.
- Reg. § 20.2041-1(a)(2) ("For purposes of §§20.2041-1 to 20.2041-3, the term 'power of appointment' does not include powers reserved by the decedent to himself within the concept of sections 2036 through 2038.") However, this requires that the power be reserved.
- If the IRS argues that the power is reserved, then Section 2038 must apply. If they argue that it is not reserved, then Section 2041 must apply. Head's you win, tails they lose.

DOUBLE BASIS INCREASE -- THE TAX BASIS REVOCABLE TRUST, THE JEST, AND THE OPT-IN COMMUNITY PROPERTY TRUST (pp. 84)

Community property gets a double basis step-up at the first spouse's death. One half of the property is included in the first spouse's gross estate, but both halves get a basis increase. IRC § 1014(b)(6).

How to get the same result in a noncommunity property state?

DOUBLE BASIS INCREASE -- THE TAX BASIS REVOCABLE TRUST (pp. 84-92)

Option 1 -- the “Tax Basis Revocable Trust”

- TAM 9308002;
- H and W created a joint revocable trust that they funded with substantially all of their assets, most of which had been held as joint tenants;
- The trustees were directed to distribute all of the net income to the grantors, and to distribute principal for the grantors' health, education, support, and maintenance;
- At the date of death of the first grantor to die, his or her one-half interest in the property would pass to the surviving grantor outright and free of trust;

DOUBLE BASIS INCREASE -- THE TAX BASIS REVOCABLE TRUST (cont'd)

- Each grantor had a lifetime power to appoint the trust assets to the creditors of his or her estate, upon a request to the trustees;
- The grantors were both co-trustees;
- If one grantor exercised the power of appointment, the other grantor's right to revoke the trust was not affected, but if the other grantor did not revoke the trust before the appointing grantor's death, then the surviving grantor's powers to revoke was subordinated to the payment of the depts and expenses of the appointing grantor's estate;
- W died one month after the trust was funded;

DOUBLE BASIS INCREASE -- THE TAX BASIS REVOCABLE TRUST (cont’d)

- The executor estate included in W’s gross estate the entire trust fund; the assets that W contributed under §2038 and the assets that H contributed under §2041;
- The executor claimed a basis increase in the entire trust fund;
- The IRS, in technical advice, agreed that 100% of the trust fund was includible in W’s gross estate, as claimed by the executor;
- The IRS denied a basis increase for the half that H contributed, however, claiming that H’s gift to the trust was revocable and, therefore, incomplete until W’s death. That meant that H’s contribution was made within 1 year of W’s death and §1014(e) applied.
- See also PLRs 200101021, 200403094, and 200604028.

DOUBLE BASIS INCREASE -- THE JEST (cont'd) (p. 88)

- The JEST (Joint Estate Step-Up Trust) is similar to the Tax Basis Revocable Trust, except that the first spouse to die gets a testamentary general power to appoint 100% of the trust.
- In default of appointment, on the first spouse's death the assets of his or her share of the trust are divided into a credit shelter trust A for the surviving spouse and descendants and a QTIP marital trust for the balance.
- If the first spouse's share of the trust is less than his or her applicable exclusion amount, the surviving spouse's share is appointed automatically to credit shelter trust B. Credit shelter trust B, for the descendants. No part of the surviving spouse's contributions passes to or in trust for the first spouse to die.

Double Basis Increase -- Alaska, South Dakota, and Tennessee Community Property Trusts (p. 92)

- Alaska, South Dakota, and Tennessee provide that property acquired by a married couple is separate property, unless the couple elect to treat it as community property.
- Alaska permits the creation of a trust to hold property as community property and treat the assets of such trusts as community property, even if the couple creating the trust do not reside within the state. AS §§ 34.77.010 to 34.77.995.
- South Dakota and Tennessee provide that holding property in trust is the only way in which to create community property in those states. S.D. Cent. Code §§ 55-17-1 to 55-17-14; Tenn. Code §§ 35-17-101 to 35-17-108.

Double Basis Increase -- Alaska, South Dakota, and Tennessee Community Property Trusts (pp. 94-97)

The Alaska Community Property Act states that property held in a trust is community property if:

- One or both spouses transfer property to the trust. AS § 34.77.100(a);
- The trust expressly declares that some or all the property transferred is community property under Title 34, Chapter 77 of the Alaska Statutes. AS § 34.77.100(a);
- At least one trustee is a "qualified person," defined as (a) an individual who resides in Alaska; (b) a trust company organized under Alaska law with its principal place of business in Alaska; or (c) a bank organized under Alaska law federal banking law, that has its principal place of business in Alaska. AS § 34.77.100(a);
- The powers of the qualified trustee include (a) maintaining records for the trust on an exclusive or a nonexclusive basis; and (b) preparing or arranging for the preparation of, on an exclusive or a nonexclusive basis, any income tax returns that must be filed by the trust. AS § 34.77.100(a);

Double Basis Increase – Alaska Community Property Trusts (pp.94-97)

- The trust is signed by both spouses. AS § 34.77.100(a); and
- The trust contains, at the beginning of the trust and in capital letters, the following declaration:

  "THE CONSEQUENCES OF THIS TRUST MAY BE VERY EXTENSIVE, INCLUDING, BUT NOT LIMITED TO, YOUR RIGHTS WITH RESPECT TO CREDITORS AND OTHER THIRD PARTIES, AND YOUR RIGHTS WITH YOUR SPOUSE BOTH DURING THE COURSE OF YOUR MARRIAGE AND AT THE TIME OF A DIVORCE. ACCORDINGLY, THIS AGREEMENT SHOULD ONLY BE SIGNED AFTER CAREFUL CONSIDERATION. IF YOU HAVE ANY QUESTIONS ABOUT THIS AGREEMENT, YOU SHOULD SEEK COMPETENT ADVICE." AS § 34.77.100(b).

Double Basis Increase -- South Dakota, and Tennessee Community Property Trusts (pp. 97-105)

- Similar to the Alaska requirements, except that there is no community property other than that held in a community property trust.

Double Basis Increase -- Community Property Trusts – Do They Work? (pp. 105-128)

Community property is exclusively a creature of state statute.

- The interest of one spouse in the property brought to the marriage or acquired during marriage by the other spouse, absent agreement between them, is generally determined by the laws of their domicile. *Westerdahl v. Comm'r*, 82 T.C. 83, 86 (1984); *Rosenkranz v. Comm'r*, 65 T.C. 993, 996 (1976); *Zaffaroni v. Comm'r*, 65 T.C. 982, 986-987 (1976).
- Community property did not exist at common law and exists in the United States solely by statute in specific states. Therefore, the status of property as community property must be determined the state statute.

Double Basis Increase -- Community Property Trusts – Do They Work? (cont'd)

- Generally, the grantor's intent determines the state law applying to a trust holding personal property, while the situs of the real property determines the situs of a trust holding real property.
- Issues of the administration of a trust holding personal property (whether tangible or intangible) are determined under the law of the place the trust is administered.
- Where the trust is administered is determined by the grantor's intent, as disclosed in the governing instrument. Absent an express declaration in the instrument, the grantor's intent is assumed to be that the trustee shall administer the trust at the trustee's principal place of business or domicile.

Double Basis Increase -- Community Property Trusts – Do They Work? (cont'd)

- Despite the rules set out in the Restatement (Second) Conflicts of Law and various cases, the courts sometimes look at things in a different manner and focus on which state has the most significant contacts. See *In re Huber v. Huber*, 493 B.R. 798 (Bankr. W.D. Wash. 2013);
- Maximize trust contacts with the state whose law you want to control, and minimize contacts with any other state.

Double Basis Increase -- Community Property Trusts – Do They Work? (cont'd) (pp. 117-120)

Comm'r v. Harmon, 323 U.S. 44 (1944)

- The U.S. Supreme Court held that the taxpayers in an opt-in community property state could not split their community property income for U.S. income tax purposes.
- The case arose out of Oklahoma, which in 1939 enacted a community property system that applied only if married Oklahoma residents opted into the system. 32 Ok. Stat. of 1941 §§ 51 *et seq.*
- The Harmons opted into the community property system, and then each reported one-half of the community property income for federal income tax purposes.

Double Basis Increase -- Community Property Trusts – Do They Work? (cont'd) (pp. 117-120)

- The Court held that the Oklahoma community property "does not significantly differ in origin or nature from such a status as was in question in *Lucas v. Earl*, where by contract future income of the spouses was to vest in them as joint tenants." 323 U.S. 44, at 46 (1944)."
- The Court noted that, under *Lucas v. Earl,* 281 U.S. 111 (1930), the spouses could not use community property to split income, under the anticipatory assignment of income doctrine.

Double Basis Increase -- Community Property Trusts – Do They Work? (cont'd) (pp. 117-120)

- The Court assumed "that, once established, the community property status of Oklahoma spouses is at least equal to that of man and wife in any community property State . . . ." 323 U.S. 44, at 47 (1944).
- Thus, the property was community property, even if opting in did not shift the incidence of taxable income.
- Rev. Rul. 77-359, 1977-2 C.B. 24 – H and W were residents of Washington state. In 1975, H and W agreed in writing that all presently-owned separate property and all thereafter acquired property would be community property. The IRS stated that the agreement changed the status of presently owned and subsequently acquired separate property into community property under state law, and should be respected for federal tax purposes.

Double Basis Increase -- Community Property Trusts – Do They Work? (cont'd) (pp. 117-120)

- Section 1014(b)(6) requires that the property be community property under the laws of any State (or possession or foreign country).
- If nonresident married persons transfer property to an Alaska, South Dakota, or Tennessee Community Property Trust, and there are sufficient contacts of the property with the trust such that that state's law should control, the property should be community property under the law of that state, and so should literally fall under the basis adjustment rules of Section 1014(b)(6).

Double Basis Increase -- Community Property Trusts – Do They Work? (cont'd) (pp. 117-120)

- The Alaska Community Property Act follows the Uniform Marital Property Act, which the IRS ruled creates community property. Rev. Rul. 87-13, 1987-1 CB 20.
- The only difference is that the Alaska rules are opt in, rather than default.
- The UMPA and Alaska law detail the rights of the parties to manage and control community property and to dispose of it at death.
- South Dakota's statute merely states that assets in a South Dakota Special Spousal Trust are community property; there is no South Dakota law explaining the management, control, or disposition at death of such property.
- Tennessee's statute only addresses dispositions at death and some rights during lifetime, but does not address management and control of community property.
- These distinctions suggest that Alaska is a safer jurisdiction to use than Tennessee or South Dakota.