

The Reciprocal Trust Doctrine: What it is & How to Avoid it

August 29, 2022



If you and your spouse have similar irrevocable trusts that benefit each other, it's important to know that such trusts might be subject to the "reciprocal trust" doctrine. Essentially, the rule prohibits tax avoidance through trusts that are interrelated and place both spouses in the same economic position as if they had each created trusts naming themselves as life beneficiaries.

Avoid this scenario

Let's suppose that your and your spouse's estates will trigger a substantial tax bill when you die. You transfer your assets to an irrevocable trust that provides your spouse with an income interest for life, access to principal at the trustee's discretion and a testamentary, special power of appointment to distribute the trust assets among your children.

Ordinarily, assets transferred to an irrevocable trust are removed from your taxable estate (though there may be gift tax implications). But let's say that two weeks later, your spouse establishes a trust with a comparable amount of assets and identical provisions, naming you as life beneficiary. This arrangement would violate the reciprocal trust doctrine. For tax purposes, the transfers would be undone by the IRS and the value of the assets you and your spouse transferred would be included in your respective estates.

In this example, the intent to avoid estate tax is clear: Each spouse removes assets from his or her taxable estate but remains in essentially the same economic position by virtue of being named life beneficiary of the other spouse's estate.

Create two substantially different trusts

There are many ways to plan trusts to avoid the reciprocal trust doctrine, but essentially the goal is to vary factors related to each trust, such as the trust assets, terms, trustees, beneficiaries, or creation dates, so that the two trusts aren't deemed "substantially similar" by the IRS.

Generally, having a long period between the establishment of the two trusts, in addition to creating separation between when gifts are made to each trust helps make the case for their differentiation. Naturally, there should be no prearranged agreement obligating donors to make future transfers.

Another way to demonstrate that trusts are not interrelated or that the donors' economic positions have changed is to ensure that the beneficiaries for each trust are different. For example, one trust could be created for the benefit of the grantor's descendants, while another could benefit the grantor's spouse and descendants (*e.g.*, a "spousal lifetime access trusts" or SLATs), or only one could have a differentiating factor of designating charities among its beneficiaries. Distinctions and dissimilarities are helpful, as is establishing a disparity in the economic positions of the donors.

The reciprocal trust doctrine can arise in a variety of situations, but with some thoughtful planning, the negative consequences can be avoided. If you have questions or concerns about your spousal trusts and the applicability of the

reciprocal trust doctrine, please contact your Anchin Relationship Partner or [Elizabeth Morin, Tax Director in Anchin's Private Client group](#).

[Contact Our Specialists](#)