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Reducing Capital Gains for Married Couples:

THE COMMUNITY PROPERTY TRUST STRATEGY YOU PROBABLY NEVER HEARD OF

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TL;DR

Geography shouldn't determine your tax bill, but it does. Couples in "Community Property" states (like TX or CA) can get a massive tax break when a spouse dies that couples in "Common Law" states (like NY or FL) don't. A Community Property Trust allows you to opt-in to the better rules without moving. It's complex, but for the right couple, it can save millions.

WHO IS THIS FOR?

Married couples in common law states with highly appreciated assets.

WHY SHOULD YOU CARE?

You hate paying taxes you don't have to pay.

THE CATCH

There are real risks (divorce, creditors, IRS ambiguity). Do not try this at home.

Introduction

Nobody likes paying taxes. We all know it, we all say it, but most of us just pay the bill and move on. No one wants to leave a tip to the IRS.

But here is the frustrating reality: **Where you live determines how much you pay.**

If you are married and live in a "Community Property" state, the tax code gives you a gift when a spouse passes away: a full step-up in basis on your assets.

If you live in a "Common Law" state? You only get half that benefit.

It doesn't seem fair, but then again, neither is the rest of the tax code. Fortunately, there is a way to level the playing field without moving across the country. It's called a **Community Property Trust.**

FIRST, A REFRESHER ON "BASIS"

To understand the opportunity, you have to understand the math.

Cost Basis is essentially what you paid for an investment. **Capital Gains Tax** is what you owe on the profit when you sell.

SCENARIO A (YOU ARE ALIVE)

You buy a stock for $10. You sell it for $100. You owe tax on the $90 gain. Simple.

SCENARIO B (DEATH)

You hold that $100 stock until you die. The IRS "steps up" your basis to the current market value ($100). Your heirs can sell it immediately and pay zero capital gains tax.

Here is the problem for married couples in common law states:

If you own assets jointly and one spouse dies, you only get a step-up on 50% of the assets. The surviving spouse is still on the hook for the capital gains on their half.

In a community property state? You get a **100% step-up.** Both halves. The entire capital gains tax liability vanishes overnight.

This is the "**Double Step-Up.**" It is arguably the most valuable income tax opportunity in the code.

THE SOLUTION: THE COMMUNITY PROPERTY TRUST

So, what if you live in New York but want the tax treatment of California?

Enter the **Community Property Trust (CPT).**

Several states (like Tennessee, South Dakota, and Florida) have created statutes that allow non-residents to "opt-in" to this treatment. You create a specific type of trust, move your appreciated assets into it, and legally agree to treat them as community property.

The Math Can Be Staggering

Let’s look at a hypothetical example.

John and Jane live in New York (a common law state). Years ago, Jane bought NVIDIA (NVDA) stock for **$100,000** in their joint account. Today, it is worth **$20 million.**

They contribute their stock to a Community Property Trust.

WHAT HAPPENS IF JOHN DIES?

THE OLD WAY

Jane only gets a step-up on John’s half of the asset. If she wants to sell the stock to diversify, she still owes tax on her original half. Her estimated tax bill? ~$2.4 million.

THE CPT WAY

The basis of the entire $20 million holding resets to the current market value. Jane sells the next day. Her tax bill? $0.

That is **$2.4 million** in savings. That is life-changing money that stays in the family rather than going to the Treasury.

There Is No Free Lunch (The Risks)

This sounds like a no-brainer, right? Not so fast.

Risk and reward are attached at the hip. If you want the tax benefits, you have to accept the trade-offs. Here are four ways this can go wrong.

THE ONE-YEAR RULE

This isn't a deathbed trade. Under IRS rules, if you transfer assets to a spouse and they die within **one year**, you do not get the step-up. Translation: You need to plan ahead. If the receiving spouse doesn't survive 12 months after the funding of the trust, the strategy fails.

THE STEP-DOWN RISK

The sword cuts both ways. If you buy a stock for $100 and it drops to $50, and your spouse dies, your basis gets "stepped down" to $50. You lose the ability to claim that tax loss. The fix: Do not put losing positions in this trust. Only use winners.

Community property trusts can create creditor-protection risk because, depending on the governing state law and how the trust is structured, a creditor of one spouse may be able to reach trust assets that would otherwise be insulated if held as that spouse's separate property. In other words, "equalizing" ownership for community property/tax purposes can inadvertently broaden the pool of assets exposed to a claim against either spouse.

DIVORCE GETS MESSY

By putting assets into a Community Property Trust, you are legally declaring them to be 50/50 property. If you get divorced, you may have just accidentally given your ex-spouse half of your property. Prenups might not save you here.

THE TAX MAN IS WATCHING

While many legal experts believe this works, the IRS has never explicitly blessed "Opt-In" Community Property Trusts. There is always a chance they challenge the double step-up in an audit. Not to mention, there are no guarantees that state taxing authorities will follow federal tax treatment of this trust structure. The bright side: If they deny it, you are likely back to where you started (paying the tax you would have paid anyway). The only true loss would likely be the legal fees you paid to set it up.

The Administrative Headache

You can't just write "Community Property Trust" on a napkin. To make this work, you generally need a **Qualified Trustee** (often a corporate trustee) in the specific state (like TN or FL) to give the trust valid legal standing.

This means:

- Setup fees.
- Annual trustee fees (potentially).
- Annual paperwork (though you can often waive the formal reporting requirements).

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CONCLUSION

Is a Community Property Trust right for everyone? Absolutely not.

But if you are in a stable marriage, live in a common law state, and are sitting on highly appreciated assets (stocks, real estate, or a business), this is a conversation worth having.

It might be for you if:

- You have a highly appreciated single stock you want to diversify.
- Your marriage is rock solid.
- You (and your spouse) are in reasonable health (surviving the 1-year window).
- You are okay with a little bit of complexity in exchange for seven-figure tax savings.

If you'd like to run the numbers on your specific situation, reach out.

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