

SOUTH DAKOTA SPECIAL SPOUSAL PROPERTY TRUSTS: SOUTH DAKOTA “STEPS-UP” TO THE PLATE AND HITS A HOME RUN FOR SURVIVING SPOUSES

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With the increased emphasis on income tax planning caused by the higher estate and gift tax exemptions and portability, many practitioners are revisiting the issue of “stepped-up” basis, which has always favored joint owners who live in community property states. South Dakota’s legislature, reacting to this phenomenon, added Special Spousal Trust legislation in 2016 that enabled surviving spouses whose property passes through the trust to receive a 100% step-up in basis on the property for federal income tax purposes, thus creating a benefit similar to that of surviving spouses in community property states.

Lucy and Ricky were longtime ranchers in western South Dakota. They sacrificed and purchased their 2000 acre ranch through the years, receiving a portion as a gift from Lucy’s father and mother. The land, which Lucy and Ricky held as joint tenants, had a federal tax basis of \$100 per acre. Their friends Fred and Ethel were longtime ranchers in Idaho, a community property jurisdiction. Fred and Ethel also sacrificed and bought their 2000 acre ranch through the years, and received a portion as a gift from Fred’s father and mother. The land was held as community property with a federal tax basis of \$100 per acre.

Last year, both Fred and Ricky died suddenly, and each of their ranches’ value had risen to \$2,100 per acre. Both Lucy and Ethel prepared to sell the ranches at fair market value for \$2,100 per acre. Lucy’s sale occurred first, and her federal tax basis in the 2000 acres was \$2,200,000.¹ The sale brought the fair market value of \$2,100 per acre for the 2,000 acres or \$4,200,000; so Lucy had a federal capital gain of \$2 million, and owed at least \$400,000 in

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¹ (\$100 per acre x 50% x 2,000 acres) = \$100,000 plus (\$2,100 stepped-up basis per acre x 50% x 2,000) = \$2,100,000 or a total of \$2,200,000. Under the Internal Revenue Code, when someone sells an asset they must pay income tax on the amount above their ‘basis’ in the property. I.R.C. §1012(a) (2012). In its most simplified sense, basis is the amount someone paid for an asset when they purchased it, or if someone received it by gift, it is the donor’s basis in the property. For example, if someone purchased one-hundred shares of a stock for \$10 per share, their basis would be \$1,000. If someone sold these shares today, they would pay income tax (at capital gain rates) on the sale price less \$1,000.

federal income taxes.² Ethel’s sale was a week later, and her federal tax basis in the 2,000 acres was \$4,200,000.³ Ethel’s sale also brought the fair market value of \$4,200,000, but because she lived in Idaho, she had no capital gain and owed nothing in federal income taxes.

This \$400,000 federal tax burden on South Dakota widows and widowers—and all citizens of Separate Property States—is caused by a unique provision of the federal tax code which recognizes a 50% step-up in basis at death of one joint tenant in non-community property states.⁴ In South Dakota, a non-community property state, the surviving spouse is only considered to receive 50% of the property from the decedent. In the Idaho example, however, the property is considered “community property held by the decedent and the surviving spouse under the community property laws of any State,” and thus the federal tax law considers the surviving spouse’s share to have come from the decedent, resulting in a 100% step-up in the basis of the property for computing capital gains.⁵

Nine states, which base their property law on Spanish and French law, have had community property as their marital property law since statehood.⁶ South Dakota and the other forty states whose laws are based on English law, have had a non-community property regime for marital property and thus are separate property states.⁷ While each of the nine community

² At the 20% capital gains tax rate. I.R.C § 1411 (2012). In many cases, an additional 3.8% tax may be required under the provisions of section 1411 of the Internal Revenue code, the net investment income tax which applies to capital gain income for those with certain levels of modified adjusted gross income. *Id.*

³ \$2,100 per acre stepped-up basis x 100% x 2,000 acres = \$4,200,000

⁴ There is an exception to this rule in the case of joint property purchased pre-1977, but it does not come up often. *See generally* Gallenstein v. United States, 975 F. 2d 286 (6th Cir. 1992) (holding that taxpayer received stepped-up basis for entire farm acquired in 1955 and was in joint tenancy with husband until his death).

⁵ I.R.C. § 1014(b)(6) (2012).

⁶ “Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas and Washington are the traditional ‘community property states.’” THOMAS M. FEATHERSTON, JR., HIS, HER OR THEIR PROPERTY: A PRIMER ON MARITAL PROPERTY LAWS IN THE COMMUNITY PROPERTY STATES 1 (July 14, 2014), <http://www.baylor.edu/law/faculty/doc.php/205011.pdf>. Wisconsin, which enacted the Uniform Marital Property Act in the 1980s, is therefore now considered a community property state since the “act codifies most of the community property principles.” *Id.* Puerto Rico is also a community property jurisdiction among United States Territories. *Id.*

⁷ For family law purposes, South Dakota is considered an Equitable Division state.

property states' laws are slightly different, a community property regime is generally similar to a fifty-fifty partnership where each spouse is considered to hold an undivided interest in the whole of the property. This is in contrast to separate property states where spouses can generally hold separate property. In a separate property state, the legal title of an asset is likely to be determinative of its ownership, and property titled in one spouse's name is presumptively that spouse's property. Conversely, in a community property state, an asset titled in one spouse's name may be either a spouse's separate property or the couple's community property, and the title is not determinative of ownership. In community property states, there generally exists a presumption that any property owned by either or both spouses during or after the marriage is community property. This presumption commonly places the burden of proof on the party asserting that a particular asset is separate property to show *why* it is separate property.

In 1998, Alaska passed a law allowing for formation of a community property trust: a statutorily defined trust providing that property transferred to the trust becomes community property held by the decedent and surviving spouse under the law of Alaska if the trust satisfies the requirements of the Alaska legislation.⁸ More recently, Tennessee passed legislation recognizing such a trust.⁹ In 2016, South Dakota passed legislation to allow spouses in the state to create a South Dakota special spousal trust.¹⁰ The Internal Revenue Service ("IRS") has not formally addressed the taxation of income or property subject to the community property election under Alaska state laws. IRS Publication 555 *Community Property*, released in March 2012, does not consider "the federal tax treatment of income or property subject to the

⁸ ALASKA STAT. ANN. § 34.77.100 (West 2016).

⁹ TENN. CODE ANN. ch. 35-17 (West 2016).

¹⁰ S.D.C.L. ch. 55-17 (2012 & Supp. 2015).

‘community property’ election under Alaska state laws.”¹¹ No reported cases or IRS rulings have addressed the federal income tax capital gains step-up of basis in property held in an Alaska community property trust or a Special Spousal Trust similar to that permitted in South Dakota.¹² The recent South Dakota legislation provides that the South Dakota Special Spousal Trust is considered a trust established under the community property laws of South Dakota, and property transferred to the trust as special spousal property means that it is community property for the purposes of I.R.C. § 1014(b)(6).¹³ Thus, the South Dakota legislation clearly intends that the surviving spouse would receive a 100% step-up in basis on the property held in the Special Spousal Trust by the decedent and surviving spouse.¹⁴ Some have suggested that a state cannot allow an opt-in to community property in this specific circumstance, but in each of the nine

¹¹ INTERNAL REVENUE SERV., CAT. NO. 15103C, COMMUNITY PROPERTY (Rev. 2016), <https://www.irs.gov/pub/irs-pdf/p555.pdf>.

¹² Some practitioners argue that a 1944 case, *Commissioner v. Harmon*, held that an elective community property statute was ineffective to equalize income between spouses for income tax purposes, and that the same analysis should apply to determining tax basis. 323 U.S. 44, 46 (1944). Other commentators argue that *Harmon* was decided before the enactment of I.R.C. §1014(b)(6) and thus should not be followed. In fact, the dissent in *Harmon* argued the incongruity of allowing community property state residents to opt out of community property treatment by agreement but not allowing common law state residents to opt in. *Harmon*, 323 U.S. at 50-51 (Douglas, J., dissenting). Those supporting the Alaska community property trust analysis cite a more recent IRS Revenue Ruling, in which the IRS recognized, for gift tax purposes, that separate property can be converted into community property under state law, which is the only technical requirement in section 1014(b)(6) with respect to the nature of the property. Rev. Rul.77-359, 1977-2 C.B. 24. Since the passage of the Alaska law in 1998, highly regarded commentators have disagreed as to whether the Alaska community property trust is effective under section 1014(b)(6). Compare DAVID WESTFALL, ET AL., ESTATE PLANNING LAW & TAXATION § 4.01(1) (4th ed. 2001 & Supp. Feb. 2011) (not effective), with Jonathan G. Blattmachr et al., *Tax Planning with Consensual Community Property: Alaska’s New Community Property Law*, 33 REAL PROP. PROB. & TR. J. 615, 629 (1999) (effective), and David G. Shaftel & Stephen E. Greer, *Alaska Enacts An Optional Community Property System Which Can Be Elected By Both Residents And Nonresidents*, SD36 ALI-ABA 1, 12-13 (1999) (effective for 100% step-up). A most recent analysis of this type of trust comes from Charles Redd, who concluded that “if clients and their advisors approach the community property trust technique with sound judgment and careful attention to detail, it may in some circumstances be an excellent basis boosting strategy.” Charles A. Redd, *Tips From the Pros: Basis Bonanza: A Few Creative Ways to Generate Step-Up*, WEALTHMANAGEMENT.COM (Feb. 19, 2016), <http://wealthmanagement.com/estate-planning/tips-pros-basis-bonanza-few-creative-ways-generate-step>.

¹³ S.D.C.L. § 55-17-5 (2012 & Supp. 2015). Note that it is only in the narrow case of transfers to the special trust that community property laws apply, and that nothing in the statute affects property law generally or as it applies, for example, to marital property that is not specifically transferred by both spouses to a Special Spousal Trust.

¹⁴ S.D.C.L. ch. 55-17 (2012 & Supp. 2015). See generally Calvin Massey, *Why New Hampshire Should Permit Married Couples to Choose Community Property*, 13 U.N.H. L. REV. 35 (2014) (discussing policy background and reasons for the allowance of marital couples opting into community property).

states where community property is the default, spouses may opt-out by agreement.¹⁵ To allow spouses to opt-in, where separate property is the default, should be considered another side of the same coin.

Property transferred to the South Dakota Special Spousal Trust is considered community property, even if one spouse or the other contributed more than 50% of the property that is transferred;¹⁶ so the South Dakota statute provides for significant disclosures between the spouses and consent of the spouses (both of whom must execute the trust).¹⁷

Some commentators conclude that the policy of facilitating marriage as an equal economic partnership for the purpose of transfers to the trust is a strong advantage to this type of trust, in addition to the federal income tax benefit. The statute provides a mechanism for creditors' claims against the spouses as the creditors attempt to reach the Special Spousal Trust property, which becomes property of both spouses.¹⁸ A good faith purchaser's reliance on property in a spouse's possession and under that spouse's management is protected in the statute.¹⁹ These creditor claims may be mitigated or extinguished by disclosure or by the use of South Dakota Codified Law chapter 55-16 (South Dakota's qualified disposition in trust "asset

¹⁵ See *supra* note 6 (listing the various community property states).

¹⁶ If the transfer between spouses of separate property is deemed a gift between spouses, it is likely to qualify for the marital deduction and not be treated as a taxable gift, regardless of the value of the donor's separate property interest for the purposes of federal gift tax. There is no South Dakota state transfer tax, gift tax, estate tax, or inheritance tax. It is possible, depending upon the date of death and the nature of the property transferred (e.g. if one spouse owned 100% of the property put into the trust), that I.R.C. section 1014(e) would preclude step-up in basis since no change in basis occurs under that statute for property given to a decedent within a year of his or her death which is reacquired directly or indirectly by the donor. Special basis rules apply to foreign (non-United States) property transferred to United States entities, like trusts, or if foreign citizens become United States citizens, and are beyond the scope of this presentation. See generally Mary F. Voce, *Basis of Foreign Property That Becomes Subject to U.S. Taxation*, 49 TAX. LAW. 341 (1996).

¹⁷ S.D.C.L. §§ 55-17-14(3), -2 (2012 & Supp. 2015). This is similar to disclosures required in S.D.C.L. chapter 55-16, which provides for qualified dispositions in trust or prenuptial agreements in South Dakota. S.D.C.L. § 55-16-15 (2012 & Supp. 2015).

¹⁸ S.D.C.L. §§ 55-17-11 to -12 (2012 & Supp. 2015).

¹⁹ S.D.C.L. § 55-17-12.

protection” statute) when forming the trust. If the trust is held as a revocable trust, the creditor claims are treated just as claims against the grantors or settlors of any other revocable trust.

The South Dakota statute requires that one or both spouses in a marriage transfer property to the Special Spousal Trust.²⁰ The written governing agreement specifically declares that some or all of the property transferred is South Dakota special spousal property pursuant to the South Dakota Special Property Trust Act and that at least one trustee is a “qualified person” which essentially means a South Dakota resident trustee.²¹ A qualified person is defined by South Dakota law under South Dakota Codified Law sections 55-3-41²² and 55-3-39,²³ which provide the requirements that the qualified person must observe. One or both of the spouses may also

²⁰ S.D.C.L. § 55-17-1 (2012 & Supp. 2015).

²¹ *Id.*

²² South Dakota Codified Laws section 55-3-41 defines a qualified person as:

- (1) An individual who, except for brief intervals, military service, attendance at an educational or training institution, or for absences for good cause shown, resides in this state, whose true and permanent home is in this state, who does not have a present intention of moving from this state, and who has the intention of returning to this state when away;
- (2) A trust company that is organized under Title 51A or under federal law and that has its principal place of business in this state; or
- (3) A bank or savings association that possesses and exercises trust powers, has its principal place of business in this state, and the deposits of which are insured by the Federal Deposit Insurance Corporation.

S.D.C.L. §55-3-41 (2012).

²³ South Dakota Codified Laws section 55-3-39 provides:

Except as expressly provided by the terms of a governing instrument or by a court order, a general law or a state jurisdiction provision stating that the laws of this state govern is valid, effective, and conclusive for the trust if all of the following are true:

- (1) Some or all of the trust assets are deposited in this state or physical evidence of such assets is held in this state and the trust is being administered by a qualified person; in this subdivision, deposited in this state, includes being held in a checking account, time deposit, certificate of deposit, brokerage account, trust company fiduciary account, or other similar account or deposit that is located in this state including South Dakota investments;
- (2) A trustee is a qualified person who is designated as a trustee under the governing instrument, a successor trusteeship, or designated by a court having jurisdiction over the trust; and
- (3) The administration, for example, physically maintaining trust records in this state and preparing or arranging for the preparation of, on an exclusive basis or a nonexclusive basis, an income tax return that must be filed by the trust, occurs wholly or partly in this state.

The State of South Dakota and its courts have jurisdiction over a trust created in a foreign jurisdiction if the administration of the trust meets the three requirements set forth in this section.

Nothing in this section may be construed to be the exclusive means of providing a valid effective and conclusive state jurisdiction provision.

S.D.C.L. § 55-3-39 (2012 & Supp. 2015).

serve as trustees.²⁴ Spouses must declare in the trust agreement that the property intended to be special spousal property is community property and that South Dakota law applies.²⁵ The trust must be signed by both spouses.²⁶

While any married couple can take advantage of the legislation, the trust would be most beneficial if the spouses have one or more of following characteristics : (1) a long term stable marriage (so that the trust will truly get the step-up at death; although the trust may also function as to trust property as a postnuptial agreement on dissolution of the marriage, that is not its primary intent and one might be better served with preparing a postnuptial agreement if the goal is only to affect division of property on dissolution);²⁷ (2) highly appreciated property, stocks, or real estate (owned by one or both spouses); (3) an over-weighted financial portfolio that the couple has delayed selling because of exposure to capital gains tax; (4) rental real estate or other real estate that the survivor does not want to manage and may immediately want to sell; or (5) property that could benefit from the 100% basis step-up, such as those who own self-created intellectual property (copyrights, art, etc.), negative basis, highly depreciated property, gold, artwork, baseball cards, stamps, coins, and other collectibles (which may be subject to a minimum 28% long-term capital gain rate).

²⁴ See S.D.C.L. § 55-3-41 (2012). If a spouse were also a qualified person, they could serve that role as trustee if desired. Note that in most instances, due to recordkeeping requirements and fiduciary duties, it may be preferable to have a corporate trustee serve along with one or both spouses as co-trustee. In the case of non-South Dakota residents creating the South Dakota special purpose trust, a South Dakota qualified person to be named as trustee will most likely be a licensed trust company or bank in South Dakota.

²⁵ S.D.C.L. § 55-17-3 (2012 & Supp. 2015).

²⁶ S.D.C.L. § 55-17-1 (2012 & Supp. 2015).

²⁷ Note the inherent conflict on joint representation of both spouses in the creation of the Special Spousal Trust. The estate planning practitioner must clarify with engagement letters and obtain client informed consent of both spouses after consultation and disclosure as required by Rule 1.7 if the drafting attorney is representing both spouses. S.D.C.L. ch. 16-18 app. A at 1.7 (2014 & Supp. 2015). Failure of an attorney to adequately research community property issues in estate planning or divorce situations has been held to constitute malpractice. *Smith v. Lewis*, 530 P.2d 589, 595 (Cal. 1975), *disapproved of on other grounds in In re Marriage of Brown*, 544 P.2d 561 (1976); *Aloy v. Mash*, 696 P.2d 656, 663 (Cal. 1985).

Second marriage clients with prior-marriage children are likely not good candidates for Special Spousal Trusts, since in many cases they want property kept separate. However, South Dakota law does allow such property to be designated separate property held in trust while other property is designated as special spousal property in the governing document of the trust.²⁸ In cases where certain property is desired to be kept separate, the parties are not required to transfer all of their property to the South Dakota Special Spousal Trust or declare it special spousal property under the trust. Instead, the parties may keep the property out of the trust or may declare in the governing document that it is not to be considered special spousal property. Finally, as with all transfers in contemplation of imminent death, there is a risk under I.R.C. § 1014(e) of not receiving the 100% step-up in basis with a deathbed transfer.²⁹

The trust agreement can include provisions concerning the rights and obligations in the property (wherever located) transferred to the trust; the management or control of the property transferred to the trust; the disposition of the property transferred to the trust on dissolution, death, or the occurrence or non-occurrence of another event; the choice of law in interpretation of the trust; and any other provisions that do not violate public policy or criminal law. Thus, the trust agreement can be extremely broad, and in general, the only specific matter which the couples may not agree upon in the trust instrument is the right of a child to child support. This comports with the general rules in South Dakota that parties to a trust can generally designate their wishes in a governing trust instrument so long as they do not violate public policy and flexibility is maintained.³⁰ Additionally, this is consistent with the South Dakota policy that

²⁸ S.D.C.L. §§ 55-17-3, -7, -8 (2012 & Supp. 2015). The federal income taxation of the trust's income during the trust period is beyond the scope of this article.

²⁹ I.R.C. § 1014(e) (2012); *see supra* note 12 (noting the various positions commentators on community property trusts take with regard to the step-up basis).

³⁰ *See generally* S.D.C.L. § 55-1-53 (2015); S.D.C.L. § 55-1B-1.1 (2012); S.D.C.L. § 55-4-30 (2012); S.D.C.L. § 55-5-12 (2012).

recognizes child support obligations as inviolate; for example, child support is one of the few obligations that are an exception to the asset protection trust in South Dakota Codified Laws chapter 55-16.³¹

As stated, there must be disclosures between the spouses entering into the agreement that would be *sufficient* to support a postnuptial agreement and are similar to those disclosures required in chapter 55-16.³² Disclosures are also similar to those required under South Dakota Codified Law sections 25-2-16 to -21 for premarital agreements.³³ South Dakota law appears not to have a compelling public policy against enforcement of postnuptial agreements between the spouses if there is full and fair disclosure.³⁴ The statute requires that both spouses execute the trust and that certain disclosures be made in the document.³⁵ A practitioner will want to document the disclosures in case there is a later challenge to the dispositive provisions of the trust instrument on dissolution of marriage.³⁶ Such challenges to trust dispositive provisions are provided in the statute.³⁷ The spouse against whom enforcement is sought may challenge the trust's enforcement if the trust was unconscionable when made, if it was involuntarily executed, or if fair and reasonable disclosures were not made or waived; and if the spouse against whom enforcement is sought did not have notice of the property and financial obligations of the spouse

³¹ S.D.C.L. § 55-16-15(1) (2012 & Supp. 2015).

³² See generally S.D.C.L. ch. 55-16 (2012) (regarding transfers which affect marital property).

³³ S.D.C.L. §§ 25-2-16 to -21 (2013 & Supp. 2015).

³⁴ See generally *In re* Estate of Smid, 2008 SD 82, 756 N.W. 2d 11 (2008) (holding that the waiver of a surviving spouse's statutory rights in trust documents was valid, regardless of the spouse's claims of unenforceability, fraud, undue influence, and mistake); *In re* Estate of Gab, 364 N. W. 2d 924, 926 (S.D. 1985) (holding that a postnuptial agreement between a husband and wife was valid and precluded the wife from taking a portion of her husband's estate because the nature and extent of the husband's property was fairly disclosed to the wife).

³⁵ S.D.C.L. §§ 55-17-1 to -2 (2012 & Supp. 2015).

³⁶ Practitioners will also want to be aware of possible gift tax consequences if one spouse transfers separate property to the other trust. While most gifts will not result on taxation due to the marital deduction, the practitioner must be aware that some property interests such as terminable interests for which QTIP elections are not filed may not qualify for the marital deductions.

³⁷ S.D.C.L. § 55-17-14 (2012 & Supp. 2015).

attempting to enforce the trust provision on dissolution.³⁸ Again—particularly when the trust seeks to provide disposition of the property on dissolution of a marriage—the drafting attorney should obtain documentation of the disclosures, possibly even as an exhibit to the trust instrument which both parties must execute. Additionally, if the document intends to provide waivers of South Dakota’s elective share, South Dakota Codified Laws section 29A-2-213 requires the waivers to be clear and to follow the statutory disclosures and requirements for South Dakota couples.³⁹

One caution is that in a rising market of asset values, the double step-up can be very valuable, but in a down market, the opposite may be true. A prudent practitioner will be aware of the basis of all assets contributed to the trust and be cautious in advising his clients which assets to transfer to the South Dakota Special Spousal Trust. The South Dakota statute allows flexibility to the spousal unit to convey some assets to the Special Spousal Trust and leave some assets out of the trust, reflecting the flexibility inherent in the South Dakota trust laws.⁴⁰

There are other more “exotic” types of trusts which may be created in an attempt to achieve a step-up in basis for federal income tax purposes, including joint exempt step-up trusts (JESTs)⁴¹ and step-up grantor retained interest trusts (SUGRITs)⁴², both of which are beyond the scope of this article. The new South Dakota statute will not be appropriate in all circumstances,

³⁸ *Id.*

³⁹ S.D.C.L. § 29A-2-213 (2004 & Supp. 2015).

⁴⁰ Sometimes, certain defective grantor trusts provide a power to exchange assets (“swap power”) based on IRS Revenue Rulings. *See, e.g.*, Rev. Rul. 2008-22, 2008-1 C.B. 796 (confirming that a power to exchange assets of equal value is benign for estate tax purposes under sections 2036 and 2038). If the drafter provided for retention of such swap powers, this could allow transfers subsequent to the trust’s creation of low-basis assets to the trust in exchange for high-basis assets to be held by the trust in the appropriate circumstance, allowing continued flexibility.

⁴¹ *See generally* Thomas E. Simmons, *How the Crummey Crumbles: Present Interest Planning With Trusts*, presented at the State Bar of South Dakota and the Committee on Continuing Legal Education, Tax Update XXXV CLE, Ramkota Hotel, Sioux Falls, SD (Dec. 13, 2013), https://works.bepress.com/tom_simmons/16/ (click the download button to access .pdf version).

⁴² Austin W. Bramwell et al., *The New Estate Planning Lexicon: SUGRITs and other Grantor Retained Interest Step-Up Trusts*, J. TAX’N, Nov., 2015, at 196.

but it gives practitioners another “arrow in the quiver” in connection with appropriate tax planning.

Community property acquired in a community property jurisdiction and transferred to a separate property state retains that status upon migration to the new jurisdiction.⁴³ Absent some action transmuting the community property into joint tenancy, tenancy in common, or some other form of separate property, the statute also provides for such a continuance when such property is transferred to a South Dakota Special Spousal Trust.⁴⁴ If out-of-state real estate from a non-South Dakota separate property state is contemplated to be transferred to a South Dakota Special Spousal Trust, it may be preferable to contribute the real estate to a limited liability company and transfer interests in the limited liability company to the Special Spousal Trust, to avoid questions of the nature of the non-South Dakota real property within the trust. The statute provides that spouses moving property from community property jurisdictions to South Dakota can put that property in the trust, and the property retains its character as community property to the extent otherwise provided by South Dakota law—so it does not change the general law described above, which provides that real property held as community property stays as community property when the holder’s residence changes to South Dakota.⁴⁵ Both residents and nonresidents may take advantage of the South Dakota Special Spousal Trust, although there must be a South Dakota qualified person as trustee.

The Special Spousal Trust may also be made the beneficiary of non-probate transfers. If the trust contains both special spousal property and property that is not special spousal property, the trustee must maintain records identifying which is which, again preserving the flexibility in

⁴³ S.D.C.L. § 55-17-5 (2012 & Supp. 2015).

⁴⁴ *Id.*

⁴⁵ *Id.* See also RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 234 (AM. LAW INST. 1971).

the trust.⁴⁶ This segregation and recordkeeping requirement is another reason to have a qualified trustee or co-trustee who is a professional to administer the trust.

Alaska, Delaware, Nevada, and South Dakota are generally considered the top states for trusts in the United States⁴⁷ Prior to the 2016 South Dakota legislation, Alaska was the only one which had authorized such a “community property trust” or “Special Spousal Trust.”⁴⁸ South Dakota is now the second state in the top-tier to recognize that such a trust will give practitioners around the United States another jurisdictional and situs choice for clients who wish a step up in basis between spouses.

With respect to the benefits of federal income tax laws’ step-up in basis, the South Dakota Special Spousal Trust truly equalizes benefits to spouses in all states of the United States, regardless of the property regimes the states have adopted or on which European countries their property laws were based. It is an idea whose time has come, although, unfortunately, it didn’t come soon enough for Lucy.

⁴⁶ S.D.C.L. §§ 55-17-7 to -8 (2012 & Supp. 2015).

⁴⁷ See Daniel G. Worthington & Mark Merric, *Which Situs is Best in 2016?*, WEALTHMANAGEMENT.COM (2016), <http://wealthmanagement.com/asset-protection/which-situs-best-2016> (listing the top states for trusts).

⁴⁸ As indicated, Tennessee also has passed community property trust legislation. See *supra* note 9.