

AUGUST 8, 2024



TEXAS Law  
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# PLANNING FOR CLIENTS WHO MIGHT HAVE A TAXABLE ESTATE

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# Estate planning is easy.

We just need to know

- (i) when a client will pass away,
- (ii) how wealthy the client will be, and
- (iii) what the tax laws will be.

# Overview

- Planning Impact of Transfer Tax Changes
- Three Groups of Clients Based on Projected Net Worth
- Core Estate Planning Alternatives
- Lifetime Gifting Strategies
- Related Ethical Issues
- Concluding Remarks

# Putting Things in Perspective: 2000 vs. 2024

| Tax Attribute                   | 2000        | 2024         |
|---------------------------------|-------------|--------------|
| Gift/Estate Exemption           | \$675,000   | \$13,610,000 |
| GST Tax Exemption               | \$1,030,000 | \$13,610,000 |
| Maximum Tax Rate                | 55%         | 40%          |
| Portability of Estate Exemption | No          | Yes          |

# New Planning Environment

- Large transfer tax exemptions, lower rates, and portability
- Shifting focus – minimize estate tax vs. income tax
- Uncertainty and fluidity of tax laws
  - Exemptions sunset in 2026
  - Potential legislation

# Three Client Groups Based on Projected Net Worth

- 1) Clients who are *unlikely* to have a taxable estate
  - Focus on non-tax objectives
- 2) Clients who are *likely* to have a taxable estate
  - Business as usual
- 3) Clients who *might* have a taxable estate
  - Get creative



# Core Estate Planning Alternatives (for Married Couples)

- All assets to surviving spouse outright
- First spouse's remaining exemption to Family Trust
- All assets to Marital Trust
- All assets to surviving spouse outright or Marital Trust, with option to disclaim into Family Trust
- Lesser known alternatives

# Surviving Spouse Outright

- Advantages
  - Simplicity
  - Minimize income tax
  - No fiduciary responsibility
- Disadvantages
  - No creditor protection
  - Potential for increased estate tax
  - GST exemption not portable

# Remaining Exemption to Family Trust

- Advantages
  - Minimize estate tax
  - Creditor protection
  - Utilize GST exemption
  - Hardwired funding
- Disadvantages
  - Complexity
  - Increased income taxes
  - Fiduciary responsibility

# Marital Trust

- Advantages
  - Creditor protection
  - Minimize income tax
  - QTIP flexibility – estate and GST tax elections
- Disadvantages
  - Complexity
  - Fiduciary responsibility
  - Cannot benefit other family members

# Disclaimer Family Trust

- Advantages
  - Same as outright gift to spouse or marital trust
  - Flexibility to reassess situation at first spouse's death
- Disadvantages
  - Complexity
  - Practical risks
  - No powers of appointment

# Lesser Known Alternatives

- Creative Family Trust provisions
  - Independent trustee/decanting
  - Third party grants general power of appointment
  - Formula general power of appointment
- Charitable-based formulas
- Clayton QTIPs

# Lifetime Gifting (for Clients Who Might Have a Taxable Estate)

- Very challenging – stuck in the middle
- Plan for flexibility and possible access to gifted assets
- Process
  - Review preliminary gifting considerations
  - Consider gifts that do not consume exemption – the “freebies”
  - Consider gifts that consume exemption – beware the “gifting threshold”

# Preliminary Gifting Considerations

- Non-tax motivations for gifting
- Client's financial needs and expected cash flow
- Client's desire to maintain control over gifted assets
- Client's risk tolerance and ability to handle complexity and follow best practices
- Client's assets, including tax basis and appreciation potential

# The Freebies

- Marital deduction and charitable deduction
- Health and education exclusion
  - Medical expenses
  - Tuition
- Annual Exclusions
  - Gift Tax
  - GST Tax

# Creative Gifting Strategies

- Balance minimizing transfer taxes vs. preserving sufficient assets to support clients
- Consider techniques that provide greater access to transferred assets but may increase IRS audit risk
- Flexibility is key
- Be mindful of ethical obligations

# Utilize Only One Spouse's Exemption

- Lifetime gifts use exemptions from the bottom, not the top
- To capture any benefit from the bonus exemptions, the “gifting threshold” is approximately \$15 million for a married couple making equal gifts, but only \$7.5 million for one spouse
- Consider practical impact to the donor spouse and the advisor’s ethical duties if both spouses are clients

# Spousal Lifetime Access Trusts

- One spouse creates irrevocable trust for primary benefit of other spouse and possibly secondary benefit of descendants
- Typically a grantor trust for income tax purposes
- Married clients often desire to create SLATs for each other, but structure to avoid “reciprocal trust doctrine”

# Irrevocable Life Insurance Trusts

- Many clients own insurance independent of tax motivations
  - Income replacement
  - Provide liquidity
- Insurance owned through an ILIT avoids estate tax
  - ILIT owns policy and client gifts cash to ILIT to pay premiums
  - Kind of annoying – third party trustee, partition community property, gift tax returns, etc.
  - Can always start with individual ownership and gift later
  - Three-year survivorship period for existing policies

# Special Power of Appointment Trusts

- Structure:
  - Client funds irrevocable trust for one or more persons, not including the client, in which a beneficiary or non-beneficiary is given a limited power to appoint trust assets among a class of persons that includes the client
- Objectives:
  - Use bonus exemptions
  - Provide client with potential access to appointed assets
  - Provide assets with creditor protection
  - Exclude assets from client's taxable estate

# Designing Trusts for Flexibility and Access

- Independent trustee with broad power to make distributions (and/or reimburse grantor for income taxes paid)
- Trust protector who can modify the trust
- Authorize trust decanting
- Give grantor swap power and ability to borrow
- Powers of appointment
- Permit grantor to serve as trustee (with HEMS distribution power)

# More Exotic and Aggressive Strategies

- Domestic Asset Protection Trusts
- Lifetime QTIP Trusts
- Retained Income Gift Trusts

# Joint Representation of Spouses

- Inherent conflict of interest between spouses
- Structuring engagement letters
- Communicate with both spouses
- Impact of partitioning community property
- SLAT disclosures and protections
- Does each spouse need separate representation?

# Other Ethical Considerations

- Competence
  - Knowing the law and staying current
- Confidentiality
  - Working with advisors and other family members
- Diligence
  - 2025 is looming
- Communication
  - Proactive (client alerts) and reactive (response time)
- Unauthorized Practice of Law
  - Delaware, Nevada, South Dakota, etc.

# Conclusion

- Advisors cannot tell the future
- But we can help clients who might have a taxable estate make informed decisions
  - Core estate plans should be as flexible as possible
  - Look before you leap on substantial lifetime gifts
  - Clients value simplicity and common sense
- No matter what happens, trusted advisors will always be in demand

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