

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

Putting Things in Perspective: 2000 vs. 2022

Tax Attribute	2000	2022
Gift/Estate Exemption	\$675,000	\$12,060,000
GST Tax Exemption	\$1,030,000	\$12,060,000
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

- (i) Clients who are *unlikely* to have a taxable estate
 - Focus on non-tax objectives

- (ii) Clients who are *likely* to have a taxable estate
 - Business as usual

- (iii) 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

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 \$14 million for a married couple making equal gifts, but only \$7 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 marital 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
- Retained Income Gift Trusts

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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