

What is a "Marital Deduction Amount" and a "Tax Free Amount"?

Estate tax planning for married couples usually involves dividing the estate of the first spouse to die into two shares. One share is the portion of a deceased person's estate that is exempt from estate tax (\$13,610,000 in 2024, adjusted for inflation each year)¹. This amount is sometimes referred to as the "Tax Free Amount." The balance of the estate, i.e., the amount that exceeds the exclusion amount in the year of death, passes to the surviving spouse (or to a Marital Trust) to defer estate tax. This excess amount is referred to as the "Marital Deduction Amount."

What is a Bypass Trust?

A Bypass Trust is a trust designed to hold the Tax Free Amount. The surviving spouse or any other qualified person or entity may serve as trustee of a suitably drafted Bypass Trust. Under the terms of the typical Bypass Trust, distributions can be made to the surviving spouse to provide for his or her health, support and maintenance in accordance with his or her accustomed standard of living. Distributions can also be made to children and other descendants from the Bypass Trust, as "secondary" beneficiaries. The surviving spouse is sometimes given a testamentary "power of appointment" (described below) over the Bypass Trust. In spite of the fact that the surviving spouse has use of the trust property during his or her lifetime (and may be given control over the disposition of the property at death), the assets in the Bypass Trust will not be taxed in his or her estate at the time of that spouse's death.

What is a Marital Trust?

A Marital Trust is a trust designed to hold the Marital Deduction Amount, i.e., the portion of a decedent's estate *in excess* of the amount that is exempt from estate tax. The value of property passing to this trust is deducted from the taxable estate of the first spouse to die, effectively deferring estate tax on this property. The surviving spouse or any other qualified person or entity may serve as trustee of a suitably drafted Marital Trust. The surviving spouse is the sole beneficiary of the Marital Trust. Under the terms of the Marital Trust, all income must be distributed to the surviving spouse. Distributions of principal can be made to the surviving spouse to provide for his or her health, support and maintenance in accordance with his or her accustomed standard of living. At the death of the surviving spouse, the assets in the Marital Trust (on which tax was deferred), as well as the surviving spouse's individual assets, will be taxed to the extent the total exceeds that spouse's Tax Free Amount.

What are Children's or Descendants' Trusts?

After the death of both spouses, assets can continue in lifetime trusts for the benefit of the children and their descendants. Each child can be given the right to become a co-trustee or sole trustee of his or her trust at designated ages. The trustees are required to provide for the health, support, maintenance and education of the children and their descendants during their lifetimes. Additionally, each child may be given a testamentary "power of appointment" (described below) to designate who is to receive the property in that child's trust. If the child does not exercise this power of appointment, any remaining trust property typically passes to the child's children, in further lifetime trusts for their benefit, on substantially the same terms as the child's lifetime trust. The major advantages in using lifetime trusts for children and other descendants are as follows:

- The trust assets will not be subject to claims of a descendant's creditors, so that a large judgment in a lawsuit will not result in the descendant losing the benefits of

¹ This exclusion amount is indexed for inflation each year until 2026, when the exclusion amount will return to \$5,000,000 indexed for inflation beginning in 2011.

these assets;

- The assets are accounted for separately from the descendant 's personal assets, so the trust assets will remain clearly segregated in the event of divorce or creditor's claims against a descendant 's spouse;
- Management assistance can be provided for each descendant who is under a specified age through a trustee or co-trustee;
- There may be potential income tax savings available through distributions directly to grandchildren or more remote descendants, who may be in lower tax brackets; and
- An exempt amount of up to \$27,220,000 in 2024 per married couple can be used to minimize estate tax when property later passes at the child's death from the children's trusts to grandchildren or other descendants.²

What is a Contingent Trust?

A Contingent Trust is a trust designed to hold property that might otherwise be distributed to a person who is incapacitated, or who is too young to manage the property prudently. It enables the trustee to make distributions to or for the benefit of the person, without subjecting the property to the control of a court-supervised guardianship.

What is a Power of Appointment?

A "power of appointment" enables the beneficiary of a trust to decide to whom the trust's assets will pass. A "testamentary" power of appointment means that the power may be exercised only at the beneficiary's death as the beneficiary provides in his or her own estate planning. Powers of appointment may be "limited" as to whom the property may be given, or "general" so that the beneficiary may give the trust property to his or her estate, and thereby, to anyone named by the beneficiary.

What is a Fiduciary?

"Fiduciary" is the term applied to anyone acting on behalf of another to manage assets that have been entrusted to the Fiduciary. The term includes an executor (who has been entrusted by the decedent to manage the assets of the estate for the estate's beneficiaries) and a trustee (who has been entrusted with the assets of the trust to manage them for the trust's beneficiaries). The same person can be both a "Fiduciary" and a beneficiary.

What Are Declarations of Guardians?

A "Guardian" is the person who is charged with caring for minor children. In Texas, children are treated as minors until they reach the age of 18. Guardians may be named in the Will, or in a separate instrument entitled "Declaration of Guardian for Minor Children." A guardian may be named for the "person" of the minor, for the "estate" of the minor, or both. A guardian of the person is responsible for making parental decisions regarding the minor's upbringing, education and welfare. A guardian of the minor's estate is charged with caring for funds that belong to the minor (but not for funds that are placed into trust for the minor, which are managed by the trustee of the trust). The same person may be named to serve as both the guardian of the minor's person and estate. This person may, but need not be, the same person who serves as the trustee of any trust created for the minor's benefit. Co-Guardians may be named as well, but if two persons are named as the Guardian of the person of a minor, those persons must be married to each other.

² These numbers are subject to the limits of the exclusion amount in effect in the year of a spouse's death.