

Bypass Trust Wills

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 (this amount is \$13,610,000 in 2024, and will change in future years due to inflation adjustments—but it will "sunset" at the end of 2025). This amount is sometimes referred to as the "Tax Free Amount." The balance of the estate, i.e., the amount that exceeds the exemption 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. If the Bypass Trust is so drafted, distributions can also be made to children and other descendants from the Bypass Trust, as "secondary" beneficiaries. Those secondary beneficiaries are often in lower tax brackets than the trust itself and the surviving spouse. Thus, including a power to make distributions from the Bypass Trust to children and grandchildren sets up the possibility of trust income being taxed at very low rates. When trust income is distributed out of the trust to a permissible beneficiary, the beneficiary pays income tax on the distributed income, not the trust. 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 a properly drafted and administered Bypass Trust will not be taxed in the surviving spouse's estate at the time of that spouse's death—no matter what those assets are worth at that time and no matter what the estate tax exemption amount is at that time. The Bypass Trust terminates upon the death of the surviving spouse or if later, the date that the children reach a designated age.

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. 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.

As a result of the Tax Cuts and Jobs Act passed in December 2017, which increased the basic estate tax exclusion amount to \$10 million, adjusted for inflation, for years 2018 through 2025 (after 2025, the estate tax exclusion amount will revert back to \$5

million, adjusted for inflation), some married couples prefer to use a Marital Trust, rather than a Bypass Trust, for the entire amount owned by the first spouse to die. The primary reason to do that is to obtain a second "adjustment" to income tax basis for the assets held in the Marital Trust when the surviving spouse dies. If the assets have increased in value by the time of the surviving spouse's death, that adjustment will be a "step up" in basis. In view of the fact that the Marital Trust assets will be included in the surviving spouse's estate (unless the executor of the deceased spouse's estate elects otherwise), if it appears that one exemption from the federal estate tax will not be sufficient to avoid estate taxes on the surviving spouse's death, the executor of the deceased spouse's estate can file a federal estate tax return (Form 706) within nine months of the deceased spouse's death and make the portability election. When the portability election is made, the deceased spouse's unused exemption amount (which is the full amount passing into the Marital Trust plus all amounts passing directly to the surviving spouse, assuming the surviving spouse is a US citizen) can be transported to the surviving spouse, which will result in the surviving spouse having more than just one exemption from the estate tax when the surviving spouse dies.

When deciding between a Marital Trust and outright gifts to the surviving spouse, there are both tax and non-tax reasons for choosing a Marital Trust. Like all irrevocable trusts, the Marital Trust can be designed to protect the assets from loss due to a divorce or other lawsuit, can provide for management of the trust assets in the event the surviving spouse loses his or her mental capacity or is not financially astute, and can protect the trust assets from being diverted to a new spouse of the surviving spouse or to other persons who the deceased spouse does not want to benefit. In addition, use of a Marital Trust can facilitate "second generation planning" for children and grandchildren.

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 in the beneficiary's Will. Powers of appointment may be "limited" so that the group of people to whom the property may be given is restricted, or "general" so that the beneficiary may give the trust property to his or her estate, and thereby, to anyone named in his or her Will.

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 is a
Guardian
Declaration?***

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 of a minor's person may be named, but only if they are married to each other.