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WHITEPAPER

Five Strategies to Safeguard Your Wealth For Future Generations

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Introduction

You're likely familiar with the many challenges that high-net-worth families often face when planning for wealth transfer such as:

- Your wealth going to taxes rather than your beneficiaries
- Planning for the fair division of assets among heirs
- Protecting your wealth, specifically, if you have a large or blended family
- Maintaining privacy
- Preparing your heirs to manage and preserve the wealth they'll inherit

While these challenges and the overall complexity of estate planning may make the process seem daunting, there are several strategies you and your estate planning advisor can employ to prepare yourself, and your family, for a smooth and successful transfer of your wealth.

First, what you need to know about the current Estate Tax

The Estate Tax is a 40% tax liability on assets above an individual's lifetime exemption. In 2023, the lifetime exemption is set at $12.92 million, which means assets above this amount will incur the 40% Estate Tax.

While married couples can combine their lifetime exemptions through estate structuring to secure both of their lifetime exemptions and protect up to $25.84 million from this tax, this won't be the case for long, because **this exemption is scheduled to be cut in half starting in 2026.** This presents a potential tax liability for high-net-worth families whose net worth exceeds or will come to exceed this reduced lifetime exemption.

You can deploy one of three strategies to mitigate, or outright avoid, the Estate Tax.

1. **Use trusts to lock in today's lifetime exemption before it gets cut in half**
2. **Deploy estate-freezing strategies to move future appreciation outside of the taxable estate**
3. **Utilize gifting methods to individuals and/or charities**

It is absolutely necessary to understand which of these strategies will fit best into your estate, as well as what types of entities are going to allow the proper execution of your estate plan.

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> The Estate Tax is a **40% tax liability** on assets **above an individual's lifetime exemption.** This exemption is scheduled to be **cut in half** starting in 2026.

Wealth transfer strategies available to high-net-worth families and their unique benefits

1 Spousal lifetime access trust (SLAT)

Spousal lifetime access trusts (SLATs) are trusts that are funded by an irrevocable gift made from one spouse to the other. The purpose of a SLAT is to protect a spouse's interests by establishing a vehicle that is governed by trust language. The SLAT can also secure an individual's lifetime exemption today, without reprisals stemming from a future reduction to said exemption. This is incredibly important because funds and assets over the lifetime exemption are subject to a 40% tax upon death.

For example, Spouse 1 may create and fund a SLAT for Spouse 2 up to the current exemption, which is $12.92 million, and Spouse 2 may do the same. This would lock in a total exemption of $25.84 million for the couple.

In today's dollars, if the scheduled lifetime exemption cut takes place in 2026, the maximum that this couple would be able to protect would only be $6.46 million each.

This means that a couple can create two SLATs, one for each spouse, and gift to each other now to fully preserve today's high exemption. It is important to note that the SLATs would need to be structured differently for each spouse, and are typically funded in different years to avoid violations of the Reciprocal Trust Doctrine.

Additional benefits of SLATs include:

Assets held in a SLAT are not subject to estate taxes upon death of the grantor

The great thing about gifting using a SLAT is that spouses do not have to pay any gift tax on gifts made to each other. Once the funds are in the trust their future appreciation is fully protected from estate tax concerns.

The grantor can remain the trustee and maintain control over the assets

The spouse funding the trust (the grantor) for a single SLAT can remain the trustee, and therefore have full control over the asset management. If the SLAT is set up as a grantor trust, the tax implications for the trust can flow through to the grantor to simplify tax filings and preserve greater wealth within the SLAT. The primary beneficiary will ultimately be the recipient spouse and the contingent beneficiaries will be whomever the couple wishes to name (typically their children or relatives).

SLATs can last for the lifetime of the beneficiaries, providing asset protection from creditors or divorcing spouses

One of the most significant benefits of a SLAT is that it can provide asset protection for beneficiaries. This means that if a beneficiary faces financial challenges, such as bankruptcy or divorce, the assets held in the trust can be shielded to avoid claims from potential creditors. This adds an extra layer of security for both the grantor and beneficiaries.

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The safest approach to avoiding even an argument of reciprocal trusts is to create two trusts that give the spouses distinctly different interests. While one spouse may be trustee of the other's trust, there should be an independent trustee of at least one trust while both spouses are alive.

Furthermore, the beneficiaries of the two trusts should be somewhat different. Perhaps, for example, one trust could give the surviving spouse a mandatory income interest and right to invade principal subject to an ascertainable standard, while the other could create a sprinkling trust in favor of the surviving spouse and descendants.

Irrevocable Life Insurance Trusts, Checkpoint Source: Zaritsky & Leimberg / Tax Planning with Life Insurance: Analysis With Forms (WG&L)

The Estate Tax SLAT example by the numbers

Let's take a look at the difference between the current exemption and the proposed exemption in 2026 using a hypothetical estate of $28 million.

	Current exemption for married couples = $27.22 million	**2026 exemption in today's dollars for married couples = $13.61 million**
Spouse 1	$13.61 million	$6.805 million
Spouse 2	$13.61 million	$6.805 million
Estate Tax	40% on assets over the threshold	40% on assets over the threshold
Collective exemption	$27.22 million	$13.61 million
Taxable estate	$28 million – $27.22 million = taxable estate of $780,000	$28 million – $13.61 million = taxable estate of $14.39 million
Estate Tax liability	40% x $780,000 = **$312,000**	40% x 14.39 million = **$5,756,000**

By locking in today's exemption, a married couple worth $28 million potentially saves $5,444,000 in estate taxes!

Keynote to remember — an estate's potential value can continue to grow over time; resulting in an estate that may be below the exemption today, eventually rising above the threshold in the future. This risk is increased by the exemption reduction set to take place in 2026.

2 Family limited partnership (FLPs)

Family limited partnerships (FLPs) typically operate as "holding companies," wherein investment interests are placed. The founders of an FLP (usually a married couple) initially have full ownership over the partnership, but will subsequently gift or sell their interest over time to other family members.

Generally speaking, assets and limited partnership interests within an FLP will be appraised and given a discounted valuation (this plays a vital role in optimizing wealth transfer). Some additional benefits of FLPs include:

Versatility in the types of assets that can be held and transferred

Within the FLP there can be stocks, bonds, real estate, and other assets, including private business interests. This flexibility allows high-net-worth families to strategically consolidate diverse assets within the FLP, thereby optimizing management and control while ensuring efficient wealth transfer.

Appreciated assets can be gifted or purchased by limited partners (LP) at a discount

FLPs have a specific hierarchical management structure involving general partners (GP) and limited partners (LP). GPs fully control the daily operations and management of FLP assets, while LPs effectively have no say over the FLP. Typically, GPs need to retain a minimum amount of equity to remain in control, but in Texas, they can retain 0% and still be in total control.

This represents a powerful benefit when creating an FLP, as it allows appreciable assets to be gifted or purchased by LPs at a discount. Additionally, any appreciation of LP interest that has been sold off or gifted is excluded from the estate of the founders.

FLPs can provide cash flow while transferring wealth

If the GPs ever need income, they can establish a management fee and pay themselves out of the FLP assets to assist with their cash flow needs.

For example, a married couple may retain complete control of all the assets that are placed within an FLP as GPs, while at the same time using the discounted valuations to optimize the transfer of their LP interest to their children over time.

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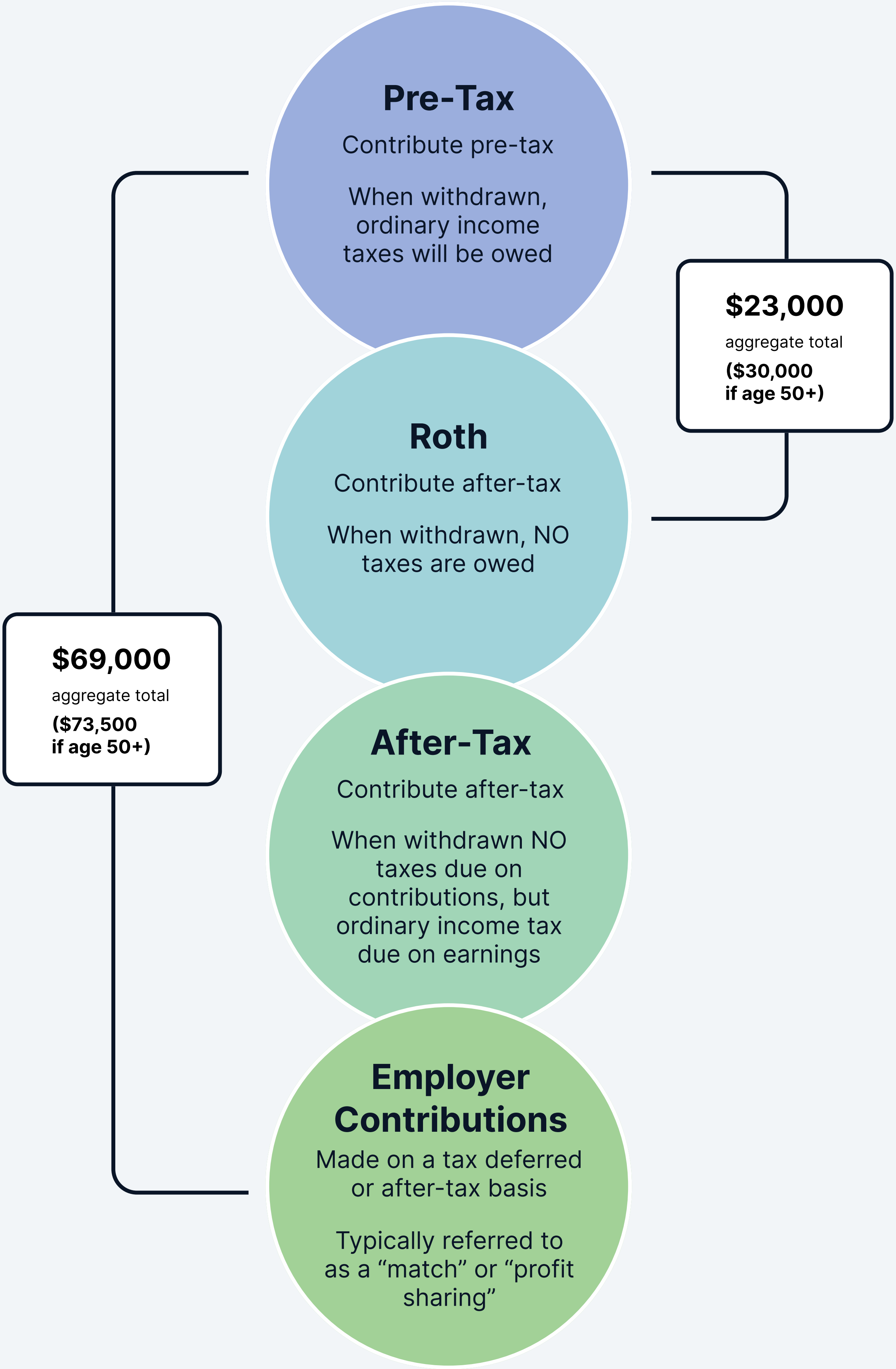
This allows wealth transfers to take place during an owner's lifetime without losing control and while protecting said wealth from potential estate tax liabilities.

An FLP can be an extremely effective partnership entity for high-net-worth families looking to mitigate their estate taxes and optimize wealth transfer to the next generation.

3 Mega backdoor Roth 401(K)

The mega backdoor Roth strategy is a great way to use funds from your paycheck to capture tax advantages ahead of retirement, and factor in legacy considerations when it comes to your beneficiaries. In order to use this strategy, your 401(K) plan MUST have the ability to make after-tax contributions alongside:

- a Roth 401(K) with the option for in-plan Roth contributions, **and/or;**
- in-service withdrawals of after-tax contributions (plus attributable prorated earnings).
    - This secondary feature would require opening a Roth IRA, and;
    - rolling over the after-tax sums into the Roth IRA.



Disclaimer

The information provided here is based on the latest available data and knowledge as of 2024.

So, how does this process work? Every year there is a maximum sum that can be placed within an individual's 401(K). As of 2024, this limit is set at $69,000 (or $76,500 if an individual is at least 50 years old). In 2024, an individual can contribute up to $23,000 (plus an additional $7,500 starting at age 50) in a pre-tax or Roth 401(K).

For example, someone age 50 can contribute $30,500 in pre-tax contributions, receive a full deduction, and then contribute an additional $46,000 in after-tax contribution for an annual retirement savings of $76,500.

Any employer match or profit sharing would simply reduce the "after-tax" contributions amount that can be made. Once the after-tax contributions are made, they need to be converted into Roth funds to take advantage of tax-free treatment for their future growth.

Benefits of a Mega Backdoor Roth include:

Mega backdoor Roths offer tax-free growth and distributions on converted funds

The mega backdoor Roth utilizes "after-tax" contributions made to a 401(K) and converts them into Roth-designated funds. Once these funds are converted, future growth and qualified distributions will be tax-free either for yourself or your beneficiaries.

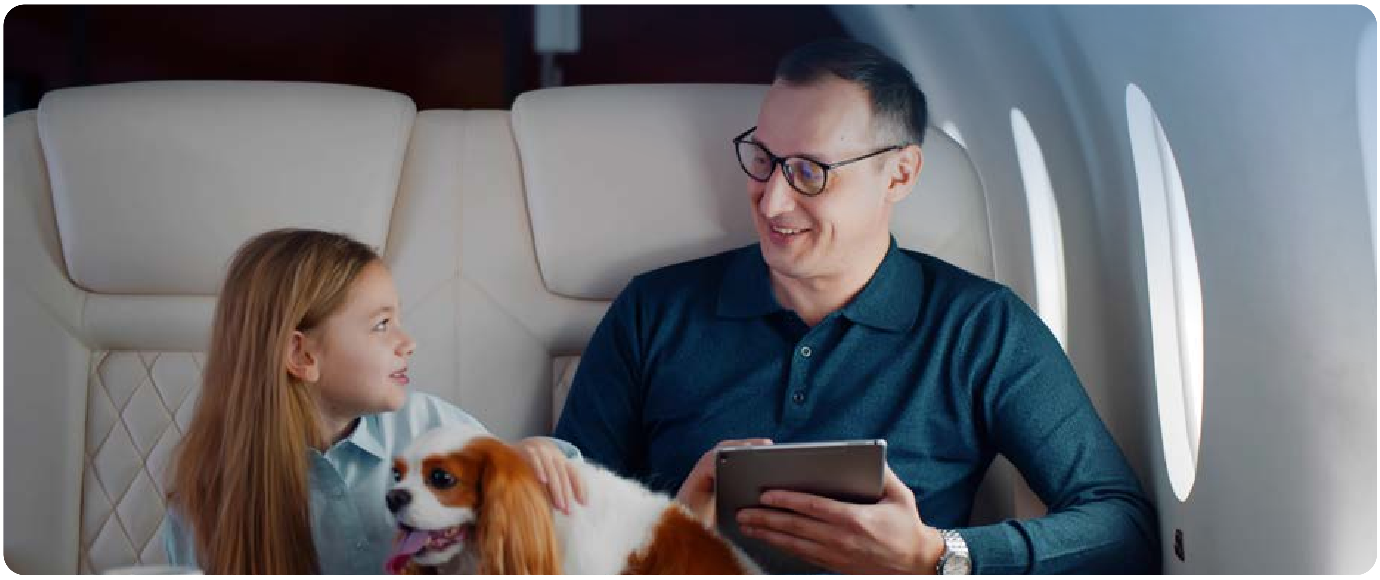
There are no required minimum distributions

Roth funds do NOT have required minimum distributions (RMDs), so you can keep these funds growing well past the RMD age threshold. An additional note to consider is that an inherited Roth account may have RMDs, but they will not be taxable under current law.

Your beneficiary/legacy can receive these funds tax-free

Since RMDs do not apply to these funds, they can grow past your threshold and continue to benefit future generations. This effectively means that your beneficiaries can withdraw from these funds at their leisure without incurring any tax penalties, thereby ensuring the continuity of your financial legacy. This can provide your beneficiaries with a significant financial advantage and provide you with an exciting opportunity for legacy planning.

> The mega backdoor Roth strategy is a great way to use funds from your paycheck to capture tax advantages ahead of retirement, and factor in legacy considerations.



4 Irrevocable life insurance trusts (ILITs)

Irrevocable life insurance trusts (ILITs) are trusts that own life insurance policies and are funded through gifting by a grantor(s). The gifts made by a grantor are irrevocable, which means once they are made, they cannot be withdrawn to benefit the grantor.

While ILITs are typically funded in the form of gifting to pay for life insurance premiums, they can also be funded by outright gifting an existing policy (this may result in a gift tax liability if the policy's cash value exceeds the annual exclusion amount). Upon the insured's death, the trust will receive the proceeds from the life insurance policy, which will then be distributed according to the terms of the trust.

An ILIT can serve many functions, however, its primary advantages can be broken down into three main benefits:

ILITs allow for safeguards to be put in place for how funds can be used and distributed

The grantor of an ILIT can specify the terms and conditions for how the funds received from the life insurance policy are used, providing a level of control over the assets within the trust even after the grantor has passed away. For example, grantors often want to ensure that funds are used for specific purposes, such as education expenses or healthcare costs.

Additionally, the grantor can also dictate when and how much money is distributed to each beneficiary, providing further protection and guidance for their loved ones.

Assets within the ILIT are NOT considered part of the grantor's taxable estate

This is true even if funds from the ILIT are used to pay for debts of the estate, which can be incredibly beneficial, as the value of a properly executed ILIT will not be subject to the 40% Estate Tax. This means that more of your wealth can be passed on to your desired beneficiaries without being diminished by estate taxes.

Life insurance proceeds within an ILIT can provide much-needed liquidity to an estate that may otherwise be tied up in non-liquid assets

An ILIT can serve as a source of funds to help cover significant estate tax liabilities. Since assets within an ILIT are not considered part of the grantor's taxable estate, they can be used to pay for any outstanding debts or taxes without being subject to estate taxes.

This means that an individual's heirs may be able to avoid selling assets they otherwise would have been forced to liquidate in order to generate enough liquidity for the payment of estate taxes.

Easing the burden during hard times

It is important to note that ILIT proceeds arrive during one of the most challenging periods that a family can go through (the loss of a loved one) — and the proceeds can make a huge difference in simplifying an estate's ability to close efficiently and thereby ease the burden on a family.

5 Bypass trust

A bypass trust is typically set to be active and funded when the first spouse passes away. Upon funding, the bypass trust secures the full lifetime exemption that the decedent is entitled to, and the assets receive a step up in basis. However, it is important to note that upon the second spouse's death, the bypass trust assets do NOT receive a step-up in basis.

Excess assets above this exemption are typically not placed within a bypass trust and are instead distributed either to a marital trust (a revocable trust that the surviving spouse can change as they wish) or simply outright (i.e. directly to named beneficiaries).

The drawbacks of a bypass trust involve mainly the logistics. There is significant complexity in setting up and managing the trust, alongside limited flexibility, and the loss of a secondary step upon the second spouse's death. The limited flexibility pertains to the distributions made by the trust, as they are limited to what the trust's provisions detail as permissible.

While a bypass trust may present some challenges to get up and running, it is a great way to automate the preservation of your lifetime exemption while at the same time protecting your wealth from taxation and your spouse from financial hardship.

Additional benefits of a bypass trust include:

Once established, assets are afforded some creditor protection

Since a bypass trust is an irrevocable trust, and the assets held in it are no longer owned by the surviving spouse, they are not subject to any liens or debts that may be incurred by the surviving spouse. This allows for greater financial stability and protection for both the trust's beneficiaries and creditors. Additionally, the trust can include provisions on how and when distributions are made to prevent creditors from seeking access to these funds.

They provide an effective means to secure an individual's lifetime exemption in a manner that is automatically triggered at death

A bypass trust plans for wealth preservation and minimizes potential estate taxes, as the future growth of the trust's assets will not be included in the beneficiary's taxable estate. Additionally, since the trust is irrevocable, it cannot be changed by the surviving spouse and provides an extra layer of protection against estate taxes.

> "While a bypass trust may present some challenges to get up and running, it is a great way to automate the preservation of your lifetime exemption.

How to choose a wealth transfer strategy for you and your family

Your family has unique circumstances, financial goals, and dynamics that must be taken into consideration when making any decision about how to structure and preserve your estate. While it is always best to work with a financial advisor and an estate planning attorney to determine the best strategy for your specific situation, here are several questions you can ask yourself to help determine your priorities when choosing a wealth transfer strategy:

1. **What are my primary goals for transferring wealth? Is it to minimize estate taxes, protect assets from creditors, ensure financial stability for my loved ones, or a mix of different factors?**
2. **How important is it for me to maintain control over the distribution of my assets after I pass away? Am I comfortable with giving up some control in order to achieve certain tax benefits?**
3. **Do I have significant assets that may be subject to estate taxes? Will my beneficiaries be able to cover these expenses without liquidating valuable assets?**
4. **How important is flexibility for me and my family? Do I want the ability to make changes to my wealth transfer plan in the future if circumstances or family dynamics change?**
5. **Do I have any specific concerns or considerations for certain family members, such as minor children, special needs individuals, or blended families?**
6. **How involved do I want my spouse to be in the management of our assets and wealth transfer plan? Do we have aligned goals and priorities when it comes to leaving a legacy for our loved ones?**

By answering these questions and discussing them with a professional, you can gain a better understanding of what you need in order to preserve your legacy and set up a successful wealth transfer. From there, you can work together to create a comprehensive plan that will meet those unique needs, and construct protection and preservation of your assets for future generations.

> "Your family has unique circumstances, financial goals, and dynamics that must be taken into consideration when making any decision about how to structure and preserve your estate.

Protect your assets and preserve your legacy with estate planning services from Avidian Wealth Solutions

It's never too early to start the process. Proper planning now can help create peace of mind and financial stability for both yourself and your loved ones in the future.

At Avidian Wealth Solutions, our boutique family office environment allows us to develop a deep understanding of your unique financial situation and goals. With this sound knowledge of your unique needs, we can offer personalized solutions for wealth transfer and estate planning that align with your values and priorities, while simplifying your life by collaborating with your existing team of attorneys.

To learn more about our services and how we can help you create a comprehensive wealth transfer strategy, schedule a conversation with us today.

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