Spousal lifetime access trusts

By Catherine McDermott
Senior Wealth Strategist
Advanced Planning Group

Advanced Planning Group

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Every legally valid estate planning technique must have an acronym, so a spousal lifetime access trust is a SLAT. Technically that is not a true statement, but estate planners sure love acronyms. I first heard the term SLAT in 2012 even though I had already been intimately familiar with this type of trust for over a decade. Fundamentally, a SLAT is just a trust that names the spouse of the grantor as a discretionary beneficiary. Hardly a revolutionary concept, but the SLAT is a remarkably useful and nuanced planning tool.

The basics

Each person has a federal gift and estate tax exclusion (inflation adjusted to $13.61 million in 2024) that can be used to shelter gifts or bequests.[1] An individual can transfer that much wealth during life, at death, or a combination of the two without paying any federal estate tax. Transfers above that sum result in a 40% federal gift or estate tax. For example, if I give my sister $4 million during my life (and have not made any prior gifts), then I would not owe any federal gift tax. If I then died and left my children $10.61 million then my total transfers would be $14.61 million and my estate would owe $400,000 of federal estate tax (40% of $1 million).[2]

There is a significant advantage to making lifetime gifts rather than waiting to use the exclusion at death, because any appreciation on those assets that occurs after the date of the gift will not be part of the transferor's estate for estate tax purposes. In the above example, if the $4 million I gave to my sister grew to $40 million before I died, then there would be no additional federal gift or estate tax on that sum and I would have been able to pass an additional $9.61 million estate tax free at my death provided that the lifetime exemption at my death is $13.61 million and my only lifetime exemption gift had been $4 million (my sister would have her own separate tax considerations).

Reluctant donors and the SLAT

While making large lifetime gifts generally allows families to transfer more total wealth to future generations, clients are often hesitant to make such transfers. It's not surprising that a couple worth $40 million is cautious when their attorney recommends giving away $27.22 million to fully utilize their estate and gift tax exclusion. A SLAT can often provide the flexibility and assurance needed to make what is otherwise an economically rational gift.

The primary beneficiaries of most trusts are the children and more distant descendants of the grantor. The distinguishing feature of a SLAT is that it benefits the grantor's spouse (as well as the grantor's descendants, possibly). Naming a spouse as a discretionary beneficiary provides a simple way for assets to be returned to the couple if their economic situation changes at some point in the future and they want some or all of the transferred funds back. The intention in creating a SLAT is that the grantor will never need the transferred funds, but naming a spouse as a beneficiary creates a "Plan B" for the family.

[1] The 2024 figures are based on a 2018 doubling of 2011's base amount of $5 million (adjusted for inflation) as a result of the Tax Cuts and Jobs Act of 2017. The law will revert ("sunset") to the 2011's original $5 million base amount (adjusted for inflation) on January 1, 2026, unless Congress takes action.

[2] The method used to calculate any federal estate taxes due assumes a 40% tax on any amount over the remaining federal estate tax exemption amount, and does not take into account the graduated tax rate on the first $1 million. As such, the estate tax amount noted above may be slightly overstated.

Since the spouse, and not the donor, is a trust beneficiary, the donor only has indirect access to SLAT funds. If the trustee makes a distribution to the beneficiary-spouse, then the beneficiary-spouse may be expected to spend that distribution in a way that benefits the married couple, but they are under no legal obligation to do so. A SLAT, therefore, may also incidentally benefit a family.

Help mitigate the risks associated with death and divorce

There are two situations in which a donor's indirect access to a SLAT ceases:

1. Death of the beneficiary-spouse; and
2. Divorce.

Oddly enough, the easier issue to plan around is the death of the beneficiary-spouse. There are four common approaches to addressing this risk.

One approach is to create two SLATs, one funded by each spouse. This way, regardless of which spouse dies first, access to half of the transferred property will continue. In this situation, care must be taken to ensure that these trusts are not deemed to be reciprocal by the Internal Revenue Service. The reciprocal trust doctrine is discussed in more detail below.

Life insurance is another common solution. Clients can purchase term insurance policies that will replace some or all of the wealth in the SLAT in the event of a premature death. For example, a 55-year old couple may create two SLATs and then purchase two 20-year term policies. If one of the spouses dies over the next 20 years, then the survivor will have access to one of the SLATs and the insurance proceeds. If they both survive 20 years, then the couple will be 75 years old and the risk of losing access to one of the SLATs is greatly reduced because their remaining life expectancies, and therefore their remaining expenses, are likely to be significantly less than they were when the trusts were created.

Third, the spouse who funds the SLAT can keep the right to exchange assets of equal value with the trust, often referred to as a "swap" power. If the beneficiary-spouse dies, the funding spouse can transfer non-income producing assets to the trust in exchange for income producing assets. Some attorneys are even comfortable exchanging a promissory note for trust assets. This allows the surviving spouse to once again obtain access to substantially all of the income produced by trust assets, if necessary.

Finally, it may be possible to give the beneficiary-spouse of the SLAT a power to appoint assets to a trust for the benefit of the original donor-spouse upon death of the beneficiary-spouse, provided that the governing law of the trust is a state with favorable domestic asset protection trust laws, or a state that has laws in place that protect a contingent reversionary interest in the trust for the donor-spouse from his or her creditors if the beneficiary-spouse were to die first (a so-called "Back-End SLAT Statute").[3] There is some risk that a spouse's contingent reversionary interest in

[3] For further discussion of domestic asset protection trusts see *Asset Protection Planning*, by Jacqueline Denton (a publication of the UBS Advanced Planning Group). In addition to states with domestic asset protection trust statutes, 10 states have adopted so-called "Back-End SLAT Statutes" that protects a contingent beneficiary interest in a trust from creditors of the donor's spouse if the beneficiary-spouse were to die first. These states are Florida, Arizona, Delaware, Kentucky, Mississippi, North Carolina, South Dakota, Tennessee, Texas and Wisconsin. George Karibjanian, *Analysis of the Viability of Statutes Creating "Back-End SLATs",* Leimberg Information Services Webinar, 10/20/2023.

a such a SLAT would cause inclusion in the donor-spouse's estate when he or she dies, and thus such a SLAT could defeat the objective of consuming gift, estate, and GST tax exemptions with the trust's funding. While that avoidance is available for certain lifetime marital trusts under existing Treasury Regulations, that same treatment has not yet been extended to contingent reversionary interest SLATs. Rather than give the beneficiary-spouse such a power of appointment, some attorneys feel more comfortable if an independent trust protector is given the power to add (or delete) the original donor as a discretionary beneficiary. Accordingly, as with all estate planning, taxpayers should seek the advice of competent legal counsel when considering employing these techniques.

With respect to divorce, instead of naming the current beneficiary-spouse by name, the trust can be drafted so it benefits whoever is married to the funding spouse at a particular time. This so called "floating spouse" definition effectively removes the current spouse as a trust beneficiary in the event of divorce.[4] In the event of remarriage, the donor's new spouse can become a trust beneficiary. However, if the donor-spouse does not remarry, the donor-spouse may lose access to the trust assets, unless the trustee has the power to lend trust property to the grantor.

SLATs must also be funded with separate property rather than joint property or community property. In other words, prior to transferring an asset to the SLAT, the asset must solely be titled in the name of the grantor. In community property states, this may require a couple to partition their community property in order to fund the SLAT with the donor's share of the partitioned property. This may create complexities if the parties later divorce. Furthermore, in some states, in the absence of a prenuptial agreement or postnuptial agreement, the SLAT assets may be, but are not necessarily, considered marital property for purposes of a divorce and division of assets.

Reciprocal trusts

In general, when a person creates a trust for their own benefit, the assets of that trust are still subject to estate tax at the death of the grantor. If both spouses create identical trusts for the benefit of the other and fund them with substantially similar assets they will be in the same position as if each had created a trust for his or her own benefit. The reciprocal trust doctrine uncrosses these types of trusts, resulting in full estate tax inclusion for both spouses.

To avoid this doctrine, when both spouses want to create SLATs, attorneys generally attempt to create differences between the two trusts. This may take the form of different trustees, different assets, different distribution provisions, different powers of appointment, different mechanisms to change the trustee, or any combination of these and other trust provisions. The key is for the two spouses to be in a legal and economically different position than if each had simply settled a trust for their own benefit.

[4] In certain states, such as Texas, the back-end SLAT statute takes a broad approach that permits an interest in the donor spouse to come into existence upon the death (or deemed death) of the beneficiary spouse, and some interpret this type of statute to permit appointment to donor spouse upon the deemed death of the beneficiary spouse. In other states, such as Florida, the back-end SLAT statute provides that the interest of the donor spouse can only arise upon the actual death of the beneficiary spouse. See Texas Prop. Code § 112.035 (g)(2) and Fla. Stat. § 736.0505(3)(a) 3.b.

A SLAT is a Grantor trust

Since the spouse of the grantor is a discretionary income beneficiary, a SLAT is considered a grantor trust for income tax purposes. When a trust is considered a "grantor trust," the grantor of the trust is treated as the owner of the trust income and trust principal for income tax purposes. This means that all items of income or deduction arising from the trust are reported on the grantor's personal income tax return, just as the grantor reports their own items of income or deduction on their personal income tax return.

Merely being a grantor trust, however, does not impact whether trust assets are subject to estate tax when the grantor dies. SLATs are almost always designed to avoid estate tax at the death of the grantor even though the grantor is treated as the owner of the trust property for income tax purposes.

A Non-grantor Trust for Spouse or SLANT

In some cases, it may be desirable to have an irrevocable trust for the benefit of a spouse (and possibly also for descendants) that is not treated as a grantor trust for income tax purposes. For instance, a grantor may want the trust to qualify as a separate taxpayer for purposes of obtaining an additional deduction for qualified small business stock, pursuant to Internal Revenue Code Section 1202.[5] In that case, the client might consider a SLANT, or Spousal Lifetime Access Non-Grantor Trust. This type of trust is similar to a SLAT with two main differences.

First, the SLANT is not a grantor trust but, instead, is taxed as a non-grantor trust. This means that the trust is its own taxpayer for income tax purposes and is taxed at a different (more compressed) income tax rate. Non-grantor trusts are subject to much more compressed income tax brackets, where the highest marginal rate of income tax (currently 37%) is reached on income over just $15,200 in 2024. As a result, many times, income will be distributed out to beneficiaries of the trust in a lower tax bracket.

Second, because the spouse is a beneficiary in a SLANT, any distributions to the spouse must be approved by an adverse party. This usually means that another trust beneficiary must approve any distributions made to the spouse. Some practitioners recommend that this adverse party approval apply to *any* distributions made to any beneficiary of the trust—not just the beneficiary spouse. One thing to keep in mind is that the beneficiary spouse cannot serve as an adverse party for purposes of approving a distribution.

Conclusion

Transferring assets to remove future appreciation from estate tax is a fundamental strategy in estate planning. By providing emergency access to trust assets in the event of unanticipated changes in the economic security of the couple, SLATs help to overcome the emotional hurdle many clients have in making large gifts. Estate planning is not merely a numbers game, and the SLAT is an important tool that helps estate planners address the very real concerns clients have regarding personal economic security. Only after that issue is addressed will a client feel comfortable making gifts of an appropriate scale to achieve their tax minimization goals.

[5] For a discussion of QSB stock, see *Qualified Small Business Stock,* by Todd Mayo (a publication of the UBS Advanced Planning Group).

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