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SPOUSAL LIFETIME ACCESS TRUSTS

A Spousal Lifetime Access Trust ("SLAT") is an irrevocable trust created by one spouse for the benefit of the other. Transfers to a SLAT do not qualify for the gift tax marital deduction. However, other people, such as children and grandchildren, may be included as beneficiaries of the SLAT. The assets transferred to a SLAT, along with any growth and income generated after the transfer—to the extent those assets are retained in the trust—should not be included in the grantor's estate or the beneficiary spouse's estate for estate tax purposes. However, the trustee may make distributions to the beneficiary spouse, if needed, pursuant to the standard and during the period specified in the trust instrument. This way, SLATs allow married couples to reduce future estate taxes without completely giving up access to the assets transferred.

WEALTH TRANSFER LANDSCAPE TODAY

The Tax Cuts and Jobs Act of 2017 (TCJA) temporarily doubled the basic exclusion amount and generation-skipping tax ("GST") exemption. While the basic exclusion amount and GST exemption are not currently scheduled to decrease until after 2025, wealth transfer planning should not be postponed, given the prospects for possible legislative changes prior to then.

For affluent couples, there has never been a more important time to prioritize wealth transfer planning. Under current law, the $11.7 million estate and gift tax exclusion will be halved in 2026. Many families are therefore looking for ways to use the exclusion before it's reduced. A SLAT is a popular and flexible wealth transfer strategy that allows a married couple to use one spouse's exclusion or both spouses' exclusions before any legislative change becomes effective, while still retaining some access to the assets transferred.

TRUST FUNDING OPTIONS

There are several ways to fund a SLAT, including a direct gift, installment sale, intrafamily loan, grantor retained annuity trust ("GRAT"),[1] or a combination of these wealth transfer strategies. In the case of a direct gift, the donor spouse uses some or all of her or his exclusion to make a tax-free gift to the SLAT. While the donor spouse ordinarily gives up all rights to the property transferred into the trust, the beneficiary spouse has access to the property through permissible trust distributions for the period specified in the trust instrument, which may be for his or her life.

Key Features of SLATs

- Irrevocable trust
- Can provide creditor protection
- Often structured as a grantor trust for income tax purposes
- Spouse is often the primary or sole current beneficiary
- Provides for the transfer of appreciating/income-producing assets to future generations without losing access to those assets
- When appropriately structured, assets held in the SLAT are not subject to estate tax upon the death of either spouse, or potentially for many generations

1. See: "Using GRATs for Efficient Wealth Transfer."

SLAT MECHANICS

The SLAT must be irrevocable, which means the grantor cannot retain the power to change the substantive terms of the trust. Also, the grantor generally should not retain any beneficial interest in the trust. The trust can be structured to benefit descendants and the grantor's spouse or be restricted to just the grantor's spouse for a specified period or for life.

If structured as a spendthrift trust, the SLAT's assets should be protected from a beneficiary's creditors' claims, including claims of a beneficiary's spouse in the event of a divorce. Under most states' laws, the trust can be drafted so that descendants receive little or no information about the trust until they become current beneficiaries under rules specified in the trust instrument—which could be well after they become adults.

SLATs generally are taxed as grantor trusts for income tax purposes, which means the grantor bears the income tax burden on any trust earnings. Ordinarily, that obligation may be "turned off" during the grantor's lifetime, but a recent change to the tax laws states that while the other spouse is a beneficiary, the grantor must continue to bear those income taxes—even if the spouses were to divorce. The grantor's payment of trust income taxes can be advantageous, as it gives the trust the potential to grow tax-free, and the payment of those taxes by the grantor is not considered an additional gift to the trust. However, assets transferred to a SLAT do not receive a "step-up" in cost basis at death like assets held in the decedent's estate.

A married couple can fund two SLATs, one for each spouse's benefit, thereby using the couple's combined $23.4 million estate and gift tax exclusion.[2] However, when creating the two SLATs, each trust must be carefully drafted and funded to avoid the trusts being considered identical or substantially similar. The issue arises from the IRS' application of the reciprocal trust doctrine, created by law in response to the perceived tax-avoidance motive, where two parties create identical trusts for each other and, as a result, end up in approximately the same economic position.

The beneficiary spouse can be given a limited power of appointment within a SLAT to incorporate additional flexibility. This power provides the ability to allocate trust assets in any manner—during life or at death—to a limited class of recipients. Those recipients generally include the descendants of the couple, in equal or unequal shares, and with similar or different parameters to those set forth in the governing instrument of the SLAT. A limited power of appointment may be beneficial when children are too young for the parents to determine with certainty what their future financial needs will be. With a limited power of appointment, a couple can postpone the determination of when and how much wealth children and younger generations will receive.

Death and divorce are significant risks that need to be considered before moving forward with a SLAT. At the beneficiary spouse's death, the grantor spouse will no longer have the means to access the trust assets. Life insurance or other mortality-hedging strategies may be used to mitigate that risk. Also, if the grantor spouse divorces the beneficiary spouse, the grantor will lose indirect access to the SLAT's assets. Some attorneys include "floating" spouse provisions that define the beneficiary as "the individual to whom the grantor is married from time to time." In the event of remarriage, the grantor's new spouse becomes a trust beneficiary.

The flexibility provided by SLATs has made this structure an increasingly popular choice for many married couples today.

2. The basic exclusion amount in 2021 is $11.7 million per spouse.

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