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SPOUSAL LIFETIME ACCESS TRUSTS (SLATs)

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An Estate Planning Strategy for Married Couples

In 2021, the federal estate and gift tax exemption allows each individual to gift up to $11.7 million free of federal estate and gift tax. Gifts in excess of this amount, other than those made to spouses or charities, are subject to 40% federal gift or estate tax.

Under current law, the 2021 exemption amount is scheduled to adjust upward for inflation annually and then be cut in half by 2026. President Biden's campaign platform suggested he would seek to drop the exemption amount before 2026; however, the president's April speech to Congress and recent Treasury budget guidance did not reference a change in the exemption amount.

While it is impossible to predict when the exemption may be adjusted in the future, it is currently at a historical high, and few people expect it to permanently remain at this level. As a result, many high-net-worth clients are hedging future decreases in the exemption amount by making gifts to irrevocable trusts. One type of irrevocable trust that is effective in utilizing a married couple's exemptions is the spousal lifetime access trust (SLAT).

What is a SLAT?

A SLAT is an irrevocable trust that one spouse creates and funds for the benefit of the other spouse. The beneficiary spouse can then access trust assets pursuant to the distribution provisions of the governing trust agreement. The SLAT is designed to utilize the exemption amount of the donor spouse, but it is not included in the other spouse's estate for estate tax purposes, even though the other spouse is a beneficiary of the SLAT.

As a result, the assets gifted to the SLAT, along with any subsequent appreciation, are not included with either spouse's estate for estate tax purposes. In most cases, each spouse forms one SLAT for the benefit of the other. SLATs can be particularly beneficial for married couples who want to plan for a possible estate tax liability but still need access to the assets in the trusts during their lifetimes.

Requirements of a SLAT

When spouses create SLATs for each other, the two irrevocable trusts must be created in such a way that the terms are significantly different from each other. If the terms of two SLATs are substantially similar, the IRS can apply the reciprocal trust doctrine. Under this doctrine, the IRS can effectively ignore the irrevocable trusts and pull the assets back into the spouses' estates for federal income tax purposes. This estate inclusion can increase the federal tax liability when the spouses die, thereby circumventing the purpose of the SLATs.

To help ensure the reciprocal trust doctrine does not apply, there should be several substantive variations between the two SLATs. Examples of substantive variations include:

- Creating and funding the SLATs at different times
- Funding the SLATs with different amounts
- Funding the SLATs with different assets
- Utilizing different trustee partners for each SLAT
- Creating variances in the beneficiaries of each SLAT (including the current beneficiaries and remote contingent beneficiaries) and the distribution standards applicable to the beneficiaries of each SLAT
- Granting the spousal beneficiary of each SLAT different powers

Funding a SLAT

When funding SLATs, it's important that each donor spouse gift individually owned assets, not joint assets. Funding a SLAT with jointly owned or community assets can result in the inclusion of the SLAT in the estate of the beneficiary spouse, as it is viewed as the spouse beneficiary self-funding the SLAT.

If the two spouses do not have sufficient separate assets to fund the SLATs, they can convert joint/community property to separate property. However, it's important to structure the conversion correctly in order to avoid the IRS's step transaction doctrine. This doctrine allows the IRS to ignore the conversion and include the assets in the spouse beneficiary's estate.

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Tax Filing Requirements

SLATs are typically structured as grantor trusts for income tax purposes. As a result, all income tax items related to a SLAT's assets are reported on the spouses' personal income tax return, and no separate return is required for the SLAT. In addition, the grantor trust status obligates the spouses to pay any income taxes associated with the SLATs from personal assets held outside the SLATs. This depletes the assets within the spouses' estates (which would potentially be subject to estate taxes at their deaths) and preserves the SLAT's assets.

Each spouse must file a separate gift tax return, as there is no option to file a joint return. However, the returns are merely to report the use of the estate and gift tax exemptions, and no gift tax is due.

For high-net-worth individuals facing an estate tax liability at death, spousal lifetime access trusts can be an excellent technique for utilizing the currently high estate and gift tax exemption amount while maintaining some access to the gifted assets.

At Creative Planning, we help our clients implement a wide range of estate planning strategies, including SLATs. As a nationally recognized wealth advisory firm, we deliver a team of credentialed, educated, experienced and action-oriented advisors, including CERTIFIED FINANCIAL PLANNER™ practitioners, certified public accountants, insurance specialists, attorneys and other professionals dedicated to helping you achieve your goals. We work together to help ensure all aspects of your financial life are well cared for. For more information about whether a SLAT makes sense for your personal financial situation, or for any other financial matter, please schedule a call.

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