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Introduction to the Spousal Lifetime Access Trust (SLAT)

In the period leading up to the 2020 presidential election, the Spousal Lifetime Access Trust (SLAT) was one of the most common estate planning techniques employed by married clients with significant wealth or those concerned with liability protection. Why? Because the SLAT protects assets from both estate taxes and creditors while simultaneously preserving access to the assets placed in the trust through the beneficiary spouse.

The transfer of assets to a SLAT can be structured as a completed gift; this will use a portion, or all, of the donor's estate tax exemption to fund the trust. In effect, the act of using the exemption now actually preserves the exemption rather than losing it if the exemption is reduced or eliminated in the future.

Though any assets withdrawn by the beneficiary spouse will be included in the spouse's gross estate, assets that are not distributed to the spouse remain in the trust and continue to grow free of estate and gift taxes for the next or future generations.

The SLAT is the perfect estate planning technique for clients with significant wealth, or those concerned about asset protection, but who are leery of giving assets up to an irrevocable trust. In the traditional irrevocable trust, the donor must freely give up access to the assets transferred to the trust. In a SLAT, however, because access to the trust assets is preserved unto the spouse, the donor is not "technically" giving up all access to the assets.

How a SLAT Works:

1. Although not required, maximum benefit is achieved when each spouse creates an irrevocable trust for the other spouse's lifetime benefit. The trust will own whatever assets you choose to transfer to the trust, including life insurance policies with existing cash value. Qualified retirement plan assets¹, however, should not be used to fund a SLAT because the transfer will result in a deemed distribution of the assets².

2. The donor spouse should not be the trustee of the trust, but the beneficiary spouse may act as trustee so long as the power to make distributions is limited by an ascertainable standard such as for a beneficiary's health, education, or support. In addition, both spouses and/or a Trust Protector can be given the right to change the trustee and/or to appoint an independent trustee to make discretionary distributions not limited to the ascertainable standard.

3. The Trust must be funded from the separate property of the grantor spouse rather than from jointly-held property. If there is insufficient separate property, jointly-held property can be divided and held as separate property for a short period of time before being transferred to the trust.

4. The transfer of assets to the SLAT will be treated as a gift for federal gift tax purposes. A gift tax return will need to be filed for the year or years in which assets are gifted to the trust. No gift tax will be due on the transfers, however, because the grantor will be using his or her lifetime gift/estate tax exemption.³

5. During the lifetime of the grantor, assets in the trust can be accessed by the trustee for the benefit of the spouse and other beneficiaries of the Trust (if any). Because the beneficiary spouse will have access to the trust assets, the donor spouse technically retains access to the assets through that relationship.

6. When the grantor dies, the assets in the trust will not be included in the grantor's gross estate for federal estate tax purposes. The trust can then continue for the benefit of the spouse (and any other beneficiaries, if desired) for the lifetime of the spouse. Upon the spouse's death, the assets will then pass to the

¹ Qualified Retirement Plan assets include assets which have not yet been subjected to income tax such as IRAs, 401Ks, 403(b)s, 457s, etc.

² Readers concerned about protecting retirement plan assets from the 10-year payout rule should consider establishing a charitable remainder trust which will protect the assets for a beneficiary's lifetime and pass any remainder to charity at the beneficiary's death.

³ The trust can also be structured as a "grantor trust" for income tax purposes if desired.

children, grandchildren, or other beneficiaries without being subject to estate tax in the spouse's estate.

7. Where both spouses have established SLATs for each other, the death of the spouse only closes the door on the assets in the grantor's SLAT, thus leaving him or her continued access to the deceased spouse's SLAT.

Why is a SLAT Particularly Beneficial Now?

- The federal estate tax laws are in a state of flux. The current gift/estate tax exemption of \$10 million (indexed for inflation⁴) will be reduced by half in 2026, but is actually expected to be reduced in the next year or two, and possibly by an even greater percentage.
- This exemption can be used during lifetime, up to the entire amount, and under the current law, even if the exemption is later decreased or eliminated, any assets given away during life which are in excess of the exemption amount in effect upon that individual's death cannot be pulled back into the individual's estate. In effect, this gives us the opportunity to give away significant wealth completely tax free if done before the laws change.
- Federal deficits are at an all-time high as a result of the current health pandemic and the massive coronavirus bailouts. The federal government will need increased amounts of money for an extended period of time to pay off the mounting debt, and taxes are almost certain to be increased in the very near future.
- Even before COVID-19, there has been considerable pressure in Congress to reduce the exemption to no more than \$3.5 million per person. Under the current laws, the estate tax impacts only about 0.1 percent of American households. If the exemption is lowered to \$3.5 million, the number of American households affected will rise to about 10%. This still doesn't seem to be significant until you consider that completely repealing the federal estate tax (which is and has been the position of the Republican party for over 2 decades) would cost the federal government more than \$256 billion over a decade⁵. Increasing it instead would add significantly more than that in additional, much needed, tax revenue.

⁴ For 2020, the exemption is \$11,700,000.

⁵ Joint Committee on Taxation estimate for 2019.

Relevant Considerations:

1. The trusts should be carefully drafted to avoid the Reciprocal Trust Doctrine. The Reciprocal Trust Doctrine is an IRS rule that applies when trusts are so interrelated that the taxpayers are left in approximately the same economic position as they would have been if they had not created the trusts. Careful drafting by an experienced estate planning attorney is necessary to avoid application of the Reciprocal Trust Doctrine.

2. Divorce or death of the spouse will alter the benefits of this technique. Consider whether to include a “floating spouse” provision, which would ensure that the trust assets would be available to any spouse. As stated, creating reciprocal trusts would protect against the premature death of the spouse.

3. The trust needs to be carefully drafted and funded to avoid inadvertent inclusion in the estate of either the grantor or the spouse.

4. Distributions from the trust to the spouse or other beneficiaries should be maintained in a separate account which is not accessible by the grantor. However, the funds could be used by the spouse for expenses attributable to jointly-owned property, joint spousal vacations, gifting, and about any other need that can be anticipated for the future.

Conclusion.

A SLAT affords an estate plan the flexibility to adapt throughout one’s lifetime while potentially maximizing gifting opportunities with the ability to be transformed in future financial and tax climates. Using your exemption prudently by assuring you retain access to the funds transferred out of your estate in case you need them in the future is indeed a very intelligent decision. And, with the uncertainties of daily living, retaining access to assets is essential for most people, especially now given the fears of what might happen with the economy and the substantial reduction in wealth many people realized in early 2020.

This publication is intended for general information purposes only and is not to be construed as providing legal advice. You must consult an attorney to discuss how the laws apply to your specific situation and how to best implement a plan that will meet your individual goals and objectives. If we can be of assistance in that regard, please call us at (757) 969-1900 to schedule a consultation appointment.