<u>What is a Spousal Lifetime Access Trust (SLAT)?</u>

By Kimberly A. Paton, Esq.

A SLAT is a type of <u>Irrevocable Trust</u> that can help save <u>Federal</u> Estate Taxes after both spouses die. The very generous current Tax exemption (approximately $12 million per spouse) is scheduled to sunset December 31, 2026. Therefore, more people need to plan to protect their wealth. Now is a perfect time because of the current Tax Exemption.

There are multiple types of techniques to protect assets, and a SLAT is a special type of trust. It is an effective tool for a couple to protect assets for their family and still retain certain control and access. The SLAT allows a person (assume a "Husband") to protect assets from his Estate Taxes by contributing an amount up to $12 million to the trust. Therefore those assets, plus all of the <u>future appreciation</u> is protected from Estate Taxes.

His spouse can serve as Trustee and also be a beneficiary of the Trust. This also allows the Husband comfort to know that he has "indirect access" to the Trust because his spouse can have direct access under the right fact pattern.

Please recognize that this technique can save millions of tax dollars, so there are rules that have to be followed carefully.

KEY PROVISIONS:

- A SLAT is an Irrevocable Trust.
- One spouse makes a gift into a trust to benefit the other spouse (and potentially other family members) while removing the assets from their combined estates.
- Under the right fact pattern, each spouse may choose to fund SLATs for each other—thereby doubling the amount that can be protected.
- The Current Federal Lifetime and Gift and Estate Tax Exemption is currently about $12 million per person in 2022, or $24 million per married couple.
- The Couple retains limited access to the assets, in the event such access is ever needed.
- Any post-gift appreciation will take place in the trust and therefore be excluded from the estate of both spouses for federal estate taxation purposes. Therefore, it is known as a "Tax Freezing Technique."

How Much Should be Contributed to the SLAT?

The appropriate amount to gift to a SLAT should be determined through careful budgeting and planning. You want to keep enough monies in your individual name to protect the tax benefit of the SLAT.

Potential benefits of a SLAT:

1. The Husband's transfer of assets to the SLAT is considered a taxable gift, but gift tax may not be owed if the donor utilizes his Federal gift and estate tax exclusion.
2. The assets and any future appreciation is removed from the donor’s taxable estate.
3. SLATs are typically structured as “grantor trusts” for income tax purposes. Therefore, the Husband pays the income tax liability personally on the income earned by the Trust. The Trust assets can appreciate faster; the Husband’s taxable estate can be reduced.
4. The current estate tax exclusion is approximately $12 million (in 2022) per person, but is scheduled to "sunset" in 2027, if it is not changed sooner.
5. If a Husband uses the high exclusion in effect until December 31, 2026, the Husband’s estate will not be not be adversely impacted after 2026 when the exclusion amount sunsets. There will be no “clawback.”
6. Like other irrevocable trusts, a SLAT can be an effective tool for multi-generational planning, known as a “dynasty trust”.

Other important Considerations:

1. Risk of death or divorce of the non-donor spouse—
   (a) If the Spouse dies or if the couple divorces, then the Husband will not have (indirect) access to the trust assets.

   (b) However, in the case of a divorce, the SLAT can provide that the Spouse cannot receive any benefits from the SLAT. Spouse's beneficial interest terminates in the trust in the event of divorce.

2. The Reciprocal Trust Doctrine—
   (a) The IRS can “disregard” a SLAT under the under the "reciprocal trust doctrine.” Care must be taken in the drafting, timing, assets contributed and administration to avoid this potential. If the IRS

disregards the Trust, there will be Estate Taxes owed on the SLAT assets.

(b) In order for the Spouse to serve as Trustee, there must be limits to the Spouse's authority. Otherwise, the IRS can include the Trust assets in the Spouse's estate. There are limits of authority or the Trust can require an "Independent Trustee" to serve too. This also protects the Trust assets from third party creditor liability.

3. Trade-offs with respect to basis step-up at death—(Capital Gains Taxes v. Estate Taxes) The SLAT assets will not obtain a "step-up" in cost basis upon the donor's death. Therefore, there could be extra capital gains taxes on the sale of the SLAT assets. Generally, the Capital gains taxes will be less than the Estate Taxes. It is important to work with your accountant to do a complete analysis. There are also certain provisions that can be added to the SLAT to allow for a reduction of the Capital Gains taxes.

4. Types of assets to fund a SLAT—Husband should only fund with his assets: not joint assets. The types of assets can be varied.

5. Although New Jersey does not currently have State Estate Taxes, these could come back. The SLAT can help reduce those too.

6. Tax return filing requirements—the SLAT does not have to file its own Income Tax Return. However, the Husband would have to file a Gift Tax Return when contributing assets to the SLAT.

This is a complicated Trust, and you should always work with legal, accounting, and financial advisors to fully understand the technique and all consequences of this technique.

We want to alert our readers to this potential solution to saving Federal Estate Taxes. We, at the Paton Law Firm, offer a variety of Estate Planning techniques, and our goal is to make this process as painless as possible.