



Spousal Lifetime Access Trusts

A Spousal Lifetime Access Trust (SLAT) offers a valuable opportunity for individuals, regardless of their level of wealth, to effectively shield assets and their potential growth from estate taxes. SLATs are structured in a way that assets transferred to the trust are intended to be exempt from estate taxes upon the death of the trust creator, also known as the grantor.

In 2024, there are unified gift, estate, and generation-skipping transfer tax exemptions, which means each individual has a \$13,610,000 exemption from each of these taxes, with this amount adjusted for inflation.

The maximum tax rate for each of these taxes is set at 40 percent.

SLAT Basics

A SLAT is an irrevocable trust specifically crafted to hold assets that are either gifted or sold by the grantor, for the benefit of the grantor's intended beneficiaries, such as the grantor's spouse and descendants.

The drafting of a SLAT is structured to provide several protective measures for the assets held within it:

- **Estate Tax Protection:** Assets transferred into the SLAT should be shielded from estate taxes upon the death of the grantor and future beneficiaries of the trust.
- **Creditor Protection:** The assets held within the SLAT should be safeguarded from claims by creditors of the grantor or any trust beneficiaries.
- **Divorce Protection:** In the unfortunate event of a divorce, the assets within the SLAT should be shielded from being divided by a court.
- **Investment Management:** A SLAT is designed to accept transfers of assets from the grantor, allowing for investments to be made on behalf of the grantor's

beneficiaries; the trustee of the SLAT is tasked with utilizing the trust assets for the welfare and support of the beneficiaries throughout their lifetimes. This ensures that the beneficiaries receive necessary assistance and resources from the trust as intended by the grantor.

Income Taxation of a SLAT

A SLAT is structured as a “grantor trust” for income tax purposes. This classification results in the income tax characteristics of the SLAT flowing through to the grantor and being reported on the grantor’s individual federal income tax return. In other words, any income generated by the SLAT is attributed to the grantor for tax purposes, allowing for potential tax advantages or considerations in the grantor’s overall tax strategy.

Risks of a SLAT

While considering the implementation of a SLAT, it is crucial to be aware of various risks associated with this planning technique:

- **Irrevocability:** Once assets are transferred to a SLAT, the gift becomes irrevocable, meaning it cannot be undone. This underscores the importance of careful consideration and planning before funding the trust.
- **Compliance with Technical Rules:** Proper funding and administration of the SLAT require adherence to technical rules. Failure to follow these rules could potentially undermine the effectiveness of the trust in achieving its intended goals.
- **Avoiding Reciprocal Trust Doctrine Violations:** It’s essential to ensure that SLATs do not run afoul of the “reciprocal trust” doctrine. This doctrine prohibits the creation of mirror-image trusts that lack meaningful differences. Distinguishing features between SLATs must be established to prevent IRS scrutiny regarding the economic positions of the grantor before and after creating the trusts.
- **Asset Protection in Divorce:** Assets held within the SLAT may not be retrievable in the event of divorce. This emphasizes the need for careful consideration of asset ownership and protection strategies.
- **Lack of Basis Adjustment:** Upon the death of the grantor, assets held within the SLAT may not receive a basis adjustment, potentially affecting future tax implications for beneficiaries.

- **Continuation of SLAT after Spouse's Death:** Upon the death of one spouse, their SLAT may continue for the benefit of the children or other named remainder beneficiaries, excluding the surviving spouse as a beneficiary. To address this, life insurance can be a valuable tool to provide liquidity for the surviving spouse and mitigate potential financial challenges.

These risks underscore the importance of thorough planning, compliance with regulations, and consideration of potential implications when utilizing a SLAT as part of estate planning strategies.

Funding a SLAT

Gifting Assets:

- The grantor can leverage their lifetime gift tax exemption to transfer assets to the SLAT.
- Utilizing this exemption allows the grantor to transfer assets to the SLAT without incurring gift taxes.
- The transfer is contingent upon the grantor having sufficient lifetime gift tax exemption available.
- This strategy provides a tax-efficient method for funding the SLAT and transferring wealth to intended beneficiaries.

Loaning Assets:

- The grantor has the option to lend assets to the SLATs, enabling them to engage in investments.
- Interest payments on the promissory note should not trigger income taxes due to the disregarded status of the SLATs for income tax purposes, a consequence of their grantor trust classification.

Selling Assets:

- In addition to establishing SLATs and leveraging the grantor's lifetime gift tax exemptions, another strategy involves selling appreciating assets to the SLATs in exchange for a promissory note.

- The promissory note can be structured with favorable terms, offering flexibility to accommodate the actual financial performance of the transferred assets.
- If the asset sold is a business interest, the promissory note may be paid with tax distributions, providing a tax-efficient method for repayment.
- For instance, if the SLAT owns interests in an S-Corporation, distributions received by the SLAT to cover income tax liability (or income from transferred assets) can be used to make payments to the grantor under the promissory note. The grantor can then utilize these funds to settle the income taxes due on the allocated income.
- Interest payments on the promissory note and the sale of assets to the SLATs are not expected to trigger income or capital gains taxes due to the disregarded status of the SLATs for income tax purposes, attributed to their grantor trust classification.
- Appreciation on the assets beyond the interest rate payable on the note is expected to avoid taxation, providing additional tax benefits.

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