

Planning Strategies

June 2020

2020: The Year of the SLAT

Why the Spousal Lifetime Access Trusts may be the perfect solution for couples seeking to do estate planning in 2020

The federal estate and gift tax exemption is currently \$11.58 million per person, the highest it has ever been. However, the exemption amount will automatically revert to \$5 million in 2026. The COVID-19 pandemic and the 2020 presidential election could trigger more rapid tax changes. A new urgency exists today to lock in the high exemption amount where possible before it goes away. The Spousal Lifetime Access Trust (or “SLAT”) provides a way to lock in your lifetime exemption while allowing your spouse access to the trust funds in the discretion of a trustee. For those with sufficient assets, the SLAT may be just the right planning solution at just the right time.

The Spousal Lifetime Access Trust (or “SLAT”) has been around for a long time. The last time SLATs were popular was in 2012 when Congress was facing the “fiscal cliff”, an artificial budgetary deadline designed to force legislative action. At the time, people worried that unless Congress acted, all sorts of tax increases would automatically ensue in 2013, one of which was that the federal estate and gift tax exemption would revert to \$1 million from \$5.12 million. Families with wealth over \$1 million wanted to make sure they didn’t lose their exemption in the event Congress couldn’t agree on a resolution and “went over the cliff.” So, in mid-2012, on the advice of estate planners, many people implemented a gifting strategy using SLATs to lock in their lifetime exemption.

What is a SLAT?

A SLAT is an irrevocable trust that functions as a lifetime credit shelter trust. That is, it’s a trust designed to absorb (and thus lock in) one’s estate and gift tax exemption, which, for federal tax purposes, is currently \$11.58 million per person, the highest it has ever been. The beneficiaries of a SLAT can be just about anyone. Your spouse and children are common but friends, grandchildren, and other relatives can also be beneficiaries. What makes the SLAT attractive is that a spouse can be a beneficiary. Although funding a SLAT is an irrevocable gift, the trustee will have the power to distribute assets to your spouse. So, in a sense, the couple can get the money back if needed. In addition, spouses may create a

SLAT for each other as long as certain rules are followed (trusts can’t be reciprocal, e.g.).

Why 2020?

The Tax Cuts and Jobs Act, enacted at the end of 2017, doubled the federal estate and gift tax exemption from \$5 million to \$10 million (plus inflation adjustments). However, many of the TCJA’s tax changes are temporary. The Act provides that on January 1, 2026, the exemption amount will automatically revert to \$5 million. As we know, what Congress can give it can take away. The COVID-19 pandemic is a game changer, as is the potential for a new presidential administration in 2021. Many politicians have called for higher taxes on the wealthy. So, the probability that Congress

will lower the federal estate and gift tax exemption much sooner than January 1, 2026, has increased dramatically. If one believes that there is a good chance that the current gift and estate tax exemptions will be rolled back, an urgency exists now to lock in the high exemption amount where possible. The strategy of using your exemption has maximum benefit for those with wealth over \$50 million who might be able to fund an irrevocable trust with \$11.58 million or even \$23.16 million, without sacrificing a major change in lifestyle. A SLAT could also work for gifts at lower amounts but would not accomplish much unless the donor makes a large enough gift to lock in a tax benefit that will disappear. That said, the loss of flexibility and control over the money placed in the SLAT poses risks that must be carefully weighed.

How does a SLAT work?

As we said, a SLAT is an irrevocable trust that functions as a lifetime “credit shelter” trust. The donor transfers wealth to a trust for his/her family so that it can be sheltered from estate and gift tax. The trustee has discretion to distribute income and principal to the beneficiaries. The trustee can also have power to make low-interest loans. The distinguishing feature is that your spouse can be one of the beneficiaries and can have access to the funds if the trustee makes a discretionary distribution. In order to keep the trust outside of your estate, the trustee should be independent. Thus, the donor’s adult children and/or a trust company might be a good choice. Alternatively, if the spouse is a trustee, he or she should have only limited discretionary powers.

Avoid creating reciprocal trusts

One cardinal rule that must be observed is the so-called “reciprocal trust doctrine.” If two people make substantially identical gifts to one another, then the gifts cancel each other out and neither is considered to have made a completed gift for tax purposes. This means that a husband and wife cannot create mirror-

image SLATs for each other. Doing so would violate the reciprocal trust doctrine and cause both to be ignored for tax purposes, thus defeating the goal of using up the lifetime exemption. However, there is a way to get around this rule. If both spouses create a SLAT, the trusts should have sufficiently different terms that they are not considered to be reciprocal. For example, the two SLATs can be created at different times, have different trustees, have different provisions with respect to the distribution of income and principal, and one SLAT might include a power appointment while the other does not. Other options are available as well.

How is a SLAT taxed?

A SLAT can be set up as its own taxable entity or as a “grantor trust.” A grantor trust is one that, under federal tax rules, is fully taxable to the grantor. The advantage of a grantor trust is that the trust itself does not pay taxes while the grantor is alive. Instead, the grantor pays taxes on the trust’s income. While that may seem like a bad deal for the grantor, it’s actually a good deal if the grantor has wealth over the federal exemption level. Because the law requires that the grantor pay the trust’s income taxes, the law essentially allows the grantor to make a tax-free gift to the trust. The other option is for the trust to be a taxpaying entity on its own. The downside to this is that an irrevocable trust pays more taxes than an individual on the same income because trusts reach the highest federal tax bracket at only \$12,950.

State estate taxes

A SLAT can also be used to lock in your state estate tax exemption. Depending on the state, the state estate tax exemption may be lower than the federal. Several states have a state level estate tax and one (Connecticut) also has a gift tax. Under a new rule, New York’s estate tax picks up gifts made within in three years of death. A few other states have an inheritance tax.

The state estate tax exemption is something to watch out for because you can easily waste it all if you're not careful. Some states have "cliff" type exemptions, which deny you any exemption at death if you go over the threshold. Only one state (Maryland) allows portability of a deceased spouse's unused exemption. As a result, there is a risk that after the first spouse dies, his or her exemption could be entirely wasted and thus cause the family to pay more state estate taxes than necessary when the second spouse passes away. A SLAT can be used to make a completed gift and essentially lock in that exemption.

What are the downsides of SLATs?

One downside of a SLAT is the risk of the spouse's death or divorce. If you're no longer married, then your ex-spouse should no longer have access to the trust. In the divorce context, this issue can be dealt with through careful planning and legal drafting. If you remarry, your new spouse can be a beneficiary of the SLAT. Another downside is that when the grantor passes away, the SLAT's assets will not be eligible for a stepped-up basis. On the death of the surviving spouse, the assets could be allowed a stepped-up basis if the trustee

grants a general power of appointment to the spouse, thus causing estate tax inclusion. These are issues to be discussed with your attorney in the planning process.

How do I set up a SLAT?

You will need an attorney to draft the trust agreement and you will have to choose a trustee. Someone who is independent is often the best choice. Next, you'll make an irrevocable gift of assets to the trust. This will trigger the filing of a federal gift tax return on Form 709, which should be prepared by an attorney or accountant.

SLATs are an advanced planning technique. There are additional aspects of these and other types of trusts that we have not covered in this paper, such as asset protection and generation-skipping planning, which may be relevant to your situation. We encourage you to work with an experienced attorney when implementing such strategies.

If you are interested in learning more about SLATs or other estate planning ideas, please contact your Portfolio Manager or Client Advisor. We would be happy to help you.



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