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SLAT:
Spousal Lifetime Access Trust

Some married couples find they've accumulated more than enough for their own needs. They're now thinking of how they can provide a legacy for their children and grandchildren, while protecting their wealth from taxes, potential creditors and divorce.

Transfer, protect and access family assets

Making lifetime gifts is a common strategy to reduce estate taxes. You can remove future growth in the value of gifted assets from your taxable estate. By making gifts today, you can also remove assets from the reach of future creditors and ex-spouses. Be sure to consult your attorney regarding your personal situation for any restrictions and limitations before making any gifts. The Tax Cuts and Jobs Act of 2017 significantly increased the lifetime estate and gift tax exemption. But, the increase is temporary and scheduled to expire after 2025. You may want to take advantage of this opportunity while you can. Gifts made to trusts can remain protected from taxes, creditors and divorce for the beneficiaries as well, possibly for many generations. Trusts can also assure family wealth is distributed to the right beneficiaries at the right time.

Setting up an irrevocable life insurance trust (ILIT) can be an effective approach. Using some of the gifts to purchase life insurance can:

- Leverage gifts into significant tax-free death benefits.
- Provide tax-free growth in policy cash values that can potentially be accessed tax-free through loans or withdrawals.

Using life insurance can enable the trust to provide a tax-advantaged source of funds to beneficiaries. Loans and withdrawals reduce the policy's cash value and death benefit, may cause certain policy benefits or riders to become unavailable, and increase the chance the policy may lapse. If the policy lapses, is surrendered or becomes a modified endowment contract (MEC), the loan balance at such time would generally be viewed as distributed and taxable under the general rules for distribution of policy cash values.

Under current federal tax rules, you generally may take federal income tax-free withdrawals up to your basis (total premiums paid) in the policy or loans from a life insurance policy that is not a MEC. Certain exceptions may apply for partial withdrawals during the policy's first 15 years. If the policy is a MEC, all distributions (withdrawals or loans) are taxed as ordinary income to the extent of gain in the policy, and may also be subject to an additional 10% premature distribution penalty prior to age 59½, unless certain exceptions are applicable.

The ideal SLAT candidate:

- Married.
- Wants to save taxes and protect assets by making gifts to irrevocable trusts.
- Would like to use your higher gift tax exemptions while you can.
- Would like to have indirect access to an additional source of income or savings.

The problem

To achieve these benefits, any gifts must be "irrevocable." In other words, once the gift is made, it's final. The grantor (the person establishing and making gifts to the trust) must give up control of the assets, and cannot retain any rights to income or benefits from the assets.

Many couples recognize the advantages of gifting, but are reluctant to irrevocably give away all rights to the assets. After all, what if things change and they find that, in the future, they need the income these gifted assets once provided? Is there any way that couples can take advantage of current gifting opportunities, protect assets from taxes, creditors and divorce, yet retain some kind of "string" to the trust just in case they need access to the assets later?

A possible solution

A Spousal Lifetime Access Trust (SLAT) could be the answer. A SLAT is an irrevocable trust for married couples often funded with life insurance. It's like a typical ILIT with a difference — the grantor's spouse is included as a trust beneficiary while the grantor is still living. The spouse, as a beneficiary, may receive income or distributions of property from the trust and can be given the power to borrow money from the trust. As a result, through the spouse, the grantor retains indirect access to trust assets.

How a SLAT works

A SLAT is drafted by an attorney

One spouse establishes the trust and is the grantor. The other spouse — the non-grantor — is a beneficiary of the trust. With proper drafting, the non-grantor spouse may also be the trustee or a co-trustee.

The grantor spouse makes gifts to the trust

The grantor uses their annual gift tax exclusions or lifetime exemption amount to make tax-free gifts to the trust, using only the grantor's separate property. Community property or property owned jointly with the non-grantor spouse should not be used.

The trustee purchases a life insurance policy

Gifts received from the grantor are used to pay life insurance premiums. The trust is the owner and beneficiary of the policy.

While both spouses are living

- Policy cash values grow income tax-free.
- The trustee can access policy cash values tax-free through withdrawals or policy loans.
- The trustee can make tax-free distributions to the non-grantor spouse according to the terms of the trust.
- The grantor spouse has indirect access to trust assets through distributions made to the non-grantor spouse.

At the grantor/insured spouse's death

- Tax-free life insurance proceeds are paid to the trust.
- The trustee can make tax-free distributions of proceeds to the surviving spouse and heirs according to the terms of the trust.

How it works

Premium paid with separate property gifts from insured spouse → Life insurance policy held in the SLAT (irrevocable trust)

→ Potential for tax-free trust distributions/loans to the non-insured spouse

→ Income and estate tax-free death benefits to spouse and heirs

Please note, life insurance policies on a single life are normally used in a SLAT, but survivorship life insurance may be used as well. Where survivorship life insurance will be purchased by the trust, special drafting issues must be considered to include eliminating the non-insured spouse as a co-trustee.

Questions

Can my spouse also serve as trustee?

Yes, however, to avoid inclusion in the taxable estate, the attorney would generally include provisions in the trust limiting distributions to amounts necessary for the spouse's health, education, maintenance and support. These limitations are referred to as "ascertainable standards," and in practice have proved to be flexible.

Can my spouse receive distributions greater than amounts for health, education, maintenance and support needs?

Yes, if an independent trustee or co-trustee is used. An independent trustee can be granted full discretion to make distributions of any amount for any reason.

Can I use survivorship (second-to-die) life insurance in a SLAT?

Yes. Although life insurance policies on a single life are normally used in a SLAT, survivorship life insurance may be used as well. However, to avoid including the life insurance in the taxable estate, neither spouse should serve as a trustee or co-trustee.

If my spouse predeceases me, how can I get access to assets in my SLAT?

With the non-grantor spouse no longer a beneficiary, the grantor's indirect access to trust assets through the spouse's distributions would end. To provide an ongoing source of funds, the trust could be authorized to loan money to the grantor. Another possible solution is for each spouse to set up their own SLAT with different terms. That way, for example, if one spouse predeceases the other, life insurance proceeds would be paid into the deceased spouse's SLAT for the benefit of the surviving spouse and other family members. The surviving spouse could then receive distributions of tax-free life insurance proceeds from their deceased spouse's SLAT. To avoid tax complications, the terms of the two SLATs must be different. Clients can arrive at the right terms in consultation with their legal advisors.

What happens if my spouse and I get divorced?

This all depends on the terms of the trust. Typically, the non-grantor spouse's rights as a beneficiary would cease if there is a divorce. If that's the case, the trust could be authorized to loan money to the grantor to continue access to trust funds.

Summary

With proper planning, couples may be able to move substantial assets out of their estate, tax-free. They may be able to further leverage and protect these gifts by providing a substantial life insurance benefit in trust for family members. While the insured is still alive, the life insurance policy may be able to generate substantial cash values over time that will grow tax-deferred. With a carefully prepared SLAT, couples can retain access to these policy cash values to potentially supplement their income through policy loans and withdrawals in the future or keep in reserve, just in case. Please remember, loans and withdrawals will reduce the face amount and cash value of your policy. You may need to fund higher premiums in later years to keep the policy from lapsing. Ultimately, the death benefit proceeds can be generally received free of estate, gift and income taxes, and managed for the benefit of all family members.

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