EQUITABLE

Advanced Markets

# Spousal Lifetime Access Trusts

## A success story

## Meet Michael and Jayne

- Mid 50s with substantial net worth
- Michael is a financial executive for a construction company
- Jayne is a real estate attorney
- Adult children living on their own

Michael and Jayne have worked with their financial professional, David, for years, staying on top of their investments, retirement and estate plans. At David's suggestion, they set up an irrevocable life insurance trust (ILIT) and made substantial gifts into the trust. Those gifted assets have now grown to $3.5 million (in addition to the life insurance policy), but are outside of the couple's control. In recent years, the very high exemption minimized the threat of estate taxes, which made the couple question their estate planning and why the ILIT had been necessary. However, in their annual review meetings, David encouraged them to keep their planning in place.

They're glad they listened to him because their net worth has continued to increase, and they are now reading quite a few articles about possible increases in estate taxes. They're also glad they have life insurance set aside in a trust. However, they're concerned the lifetime exemption (amounts that can be gifted or willed without triggering a federal tax) will be substantially reduced, making it more difficult to fund their ILIT. They're also concerned that with continued investment growth, estate taxes could eat away at the assets they have outside the ILIT.

### Next step: Spousal Lifetime Access Trust (SLAT) offers flexible planning

After discussing their concerns with David, he proposes they set up at least one SLAT. Moving assets into one of these trusts will forever carve those assets out of their estates, yet still provides for one of the spouses. They target moving $5 million out of their joint estate into a SLAT.

## Michael's hesitancy about irrevocable gifts resurfaces

Michael is concerned the SLAT, like the ILIT, will forever remove assets from the couple's access and control.

David knows the couple has more assets than they need to live on, but he also realizes he must address Michael's concerns. He explains that SLATs are built for flexibility and intended to provide for one of the spouses as a beneficiary, while they are still alive.

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**Here's how it would work:**

**1**

Assets are gifted from Michael (the grantor) out of the estate and into the SLAT.

**2**

The trustee of the SLAT can distribute trust funds to Jayne (as beneficiary) based on what are called "ascertainable standards" built into the trust, while she is alive.

**3**

Michael can borrow assets back from the trust, provided he does it as an "arm's length" loan — a loan with market standard terms and interest rates.

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**David shows them a diagram of how such a trust might work.**

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.

## Michael raises one more concern

Michael realizes that since the trust would be for Jayne's benefit, if she were to pre-decease him, the trust assets would no longer be available to her and the trust funds would move to the children.

David has a strategy. The couple could set up trusts for each other and fund each with half the assets they planned to gift to a single trust (the revised plan would have $2.5 million for each trust). Michael would create a trust for Jayne's benefit and Jayne would create a trust for Michael's benefit, allowing each spouse to have a trust for their benefit. David notes they'll need the estate planning attorney to make certain the trusts are not mirror images, or else the IRS could hold that no gift was made outside of the estate.

## Life insurance may enhance the approach

To address Michael's concern about loss of assets on the death of a spouse, David adds life insurance into the mix. Each trust could own a policy on the grantor spouse. For example, the trust created by Jayne to benefit Michael could own a policy on her life, and vice versa.

- If Jayne were to pre-decease Michael, he would still have access to the trust funds in which he is the beneficiary. He would also have increased funds provided by the death benefit paid on Jayne's life.
  - The reverse would occur if Michael were to pre-decease Jayne.
- They could accomplish this using a relatively small portion of the funds in the trust to pay the life insurance premiums.

## David proposes an Equitable life insurance policy on both spouses

Each trust could pay $50,000/year out of the $2.5 million gifted. Using what's called a seven-pay strategy, the policy would be paid up over 7 years. Over a period of years, this approach will carve out $350,000 of the $2.5 million gifted to each trust toward premiums.

**By adding Equitable's life insurance to the plan, the couple sees several benefits:**

**Death benefits that can enhance the couple's planning.**

**If a variable life policy is used, the couple's asset manager can use the wide range of investment choices to replicate their portfolio within the trust and the life insurance policy.[1]**

**Under Tax Code §7702, the life insurance contract allows funds to accumulate income tax-free. Moreover, those assets can be withdrawn via loans and withdrawals in a tax-advantaged manner.[2]**

1 Note: As a variable life insurance contract, the cash surrender value will be subject to market fluctuations.

2 Under current federal tax rules, your clients generally may take federal income tax-free withdrawals up to their basis (total premiums paid) in the policy or loans from a life insurance policy that is not a Modified Endowment Contract (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. Loans and partial withdrawals will decrease the death benefit and cash value of your client's life insurance policy and may be subject to policy limitations and income tax. In addition, loans and partial withdrawals may cause certain policy benefits or riders to become unavailable and may increase the chance your client's policy may lapse. If the policy lapses, is surrendered or becomes a 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.

## What did the planning accomplish?

By establishing SLATs for both Jayne and Michael, the couple has accomplished these objectives:

- The couple enhanced their earlier estate planning by removing additional assets from their estate, allowing for flexible access should either spouse need the funds.
- By using two trusts, they can gift the same targeted amount out of their estates, but still protect each other.
- By adding a cash value life insurance policy for a portion of the trust assets, they can enhance the trust assets passing to the beneficiaries — either the surviving spouse or their children.
- Their asset manager can continue to manage their funds, but within an account set up for each trust.
- Their asset manager can take advantage of any of Equitable's VUL investment options to help allocate the policy's funds along an asset allocation similar to the couple's overall investments. This will help keep the trust assets in sync with their objectives and financial risk tolerance.
- By using a permanent cash value life insurance policy, the funds inside the policy can accumulate income tax-free and, with proper planning, can be accessed via withdrawals and loans,[1] to supplement trust distributions. All this can help the couple's and the trustee's overall income tax management.[2]

## Why Equitable?

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More than **$350** billion assets under management[3]

**Highly rated** by all the major rating agencies

A variety of innovative life insurance strategies that help clients with long-term planning needs.

Access to AEGIS illustration software templates that show SLAT, asset location and life insurance as an asset.

3 The references of over 160 years of financial strength, over 2.8 million clients and more than $350 million in assets under management applies exclusively to Equitable Financial Life Insurance Company.

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