

Spousal Limited Access Trusts – Having your Cake and Eating it too

While the 2017 Tax Cut and Jobs Act doubled the lifetime gift and estate tax exemption (presently \$11,400,000), the increase is only temporary. In 2026, the increased exemption is set to “sunset”, and the estate and gift tax exemption will revert to its pre-tax cut level. Because the increase is presumably only temporary, certain high net worth individuals have a limited window to reduce their taxable estates by making gifts that utilize all or most of their lifetime exemptions.¹

In order for a transfer to qualify as a taxable gift (and removed from an individual’s estate for estate tax purposes), the individual making the gift has to surrender sufficient control of, and any beneficial interest in, the assets being gifted. An individual contemplating a gift that will use most or all of the increased exemption will therefore lose the ability to financially benefit from the asset being transferred. For some, the prospective loss of this financial benefit may be too costly – they may need the income generated by the gifted assets to maintain their standard of living, or they may fear that they will not be as well off in the future and may later need the gifted asset.

For married individuals that are interested in using the increased exemption but have concerns about losing the financial benefit of the assets being transferred, a Spousal Limited Access Trust (SLAT) may provide a solution. Under the terms of a SLAT, the spouse of the creator of the trust is the primary beneficiary of the trust. Because the spouse is a beneficiary of the SLAT, the creator of the trust (the “Grantor”) indirectly benefits from distributions made by the trust. Moreover, the assets that the Grantor transfers to the SLAT are taxable gifts that are removed from the Grantor’s estate for estate tax purposes (and all future appreciation of the transferred assets will be outside of the Grantor’s estate). A SLAT, therefore, is a middle road for clients that are interested in using their increased estate and gift exemption but are concerned about losing the financial benefit of the asset being transferred.

The terms of the SLAT may be specifically tailored to meet a client’s objectives:

- If the client is concerned that the gift may adversely affect his or her standard of living, the SLAT can provide for liberal distributions to the spouse during his or her lifetime,

¹ In November 2018, the IRS stated that in the event that the estate and gift tax exemption is lowered to pre-tax cut levels, it will not seek to collect gift or estate taxes for gifts made during this period.

such as mandatory distributions of the trust's income, a right to withdraw the greater of \$5,000 or 5% of the trust's principal, and liberal principal invasion standards. The consequence of having principal liberally distributed or withdrawn from the SLAT, however, is that the amounts withdrawn from the trust are added to the spouse's estate and/or prevent the Grantor and his/her spouse from spending down the assets that remain in their respective estates.

- If the client is more concerned about the trust's assets being available only in the event of need – i.e., a rainy day fund – the dispositive provisions can be limited to the “sprinkling” of principal and income, in the trustee's discretion, for the spouse for his or her health, education, maintenance and support. These limited dispositive provisions will preserve the trust's principal, thereby maximizing the efficacy of the gift.

Although SLATs offer the benefits described above, they do have some drawbacks:

- First and perhaps most importantly, a Grantor of a SLAT can only indirectly benefit from distributions from the trust as long as his or her spouse is alive. When the spouse dies, his or her interest in the trust terminates, and the trust becomes payable to the successor or remainder beneficiaries. If the Grantor relied on distributions from the trust, or if the spouse dies prematurely, this will negatively affect the Grantor's standard of living.
- A SLAT is irrevocable and the terms of the trust cannot be changed. Therefore, if a married couple divorced, the trust beneficiary/spouse will continue to benefit from the trust.
- While each spouse may create a separate SLAT, the trusts must be sufficiently different from one another in order to avoid the reciprocal trust doctrine. As a result, one spouse may have more limited access to distributions from the trust.

An estate planning transaction involving a SLAT should therefore involve careful coordination among the client, the attorney, and the client's accountant and/or financial advisor in order to: (a) ensure that a SLAT is an appropriate vehicle for the client; and (b) determine the size and type of gift that should be made to the trust.

Despite these drawbacks, for clients interested in taking advantage of the increased exemption's limited window, a SLAT can be a great way to use the exemption without entirely surrendering the financial benefits of the asset being gifted. It's like having your cake and eating it too.

For more information on SLATs or the increased exemption, please contact Harris Markhoff, Michael Markhoff or Christopher Miehl.

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