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Wealth Planning Update

Leveraging a Spousal Lifetime Access Trust

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In this Wealth Planning Update:

- » *The Tax Cuts and Jobs Act reduces the number of estates impacted by the estate tax, but with changing administrations and the possibility of repeal, estate planning cannot be postponed. Doing so can put your family in a position where they are unprepared to deal with the financial consequences after your death.*
- » *Spousal lifetime access trusts (SLATs) are a flexible estate planning tool that may help you to be prepared for the long term, despite what happens to the transfer tax system. When funded with appropriately selected assets, SLATs offer the opportunity to maximize growth and tax-advantaged wealth transfer.*

Benjamin Franklin’s observation “in this world nothing can be said to be certain, except death and taxes” still rings true. While many prepare for their final life events by carefully constructing estate plans, changes in administrations can result in uncertainty and delayed planning due to potential tax law reform. The Tax Cuts and Jobs Act that became effective January 1, 2018 roughly doubled the 2017 exemption value for the estate tax. The 2019 exemption is \$11,400,000; however, the longevity of this exemption is unknown. It sunsets in 2025 and could possibly be repealed by a future Congress and president before then. While some may argue that an estate plan is unnecessary given the level of the current exemption, the reality is that inaction is a risky and potentially costly approach. Failure to create and maintain an estate plan can open one up to many levels of financial exposure.

However, estate planning is built on more than tax liability; there's also multi-generational gifting and long-term planning. All of these may be addressed with the use of a Spousal Lifetime Access Trust, which also offers a component of flexibility—regardless of what happens to the transfer tax system.

What is a Spousal Lifetime Access Trust?

A Spousal Lifetime Access Trust (“SLAT”) is an irrevocable trust created by one spouse for the benefit of the other as well as additional family members, most commonly children and/or grandchildren. The grantor, or “donor spouse,” uses their gift tax exemption to make a gift to the SLAT, and the “beneficiary spouse” is named as a current beneficiary. While the donor spouse gives up his or her right to the property transferred into the trust, the beneficiary spouse maintains access to that same property. The trust can be structured as appropriate for each family.

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Some families allow only the beneficiary spouse to access funds during his or her lifetime while children and grandchildren benefit after the beneficiary spouse's death. Still other family's structure SLATs to permit distributions to the beneficiary spouse and children simultaneously. Additional trust parameters can be added as appropriate.

Potential Tax Advantages

The 2019 estate and gift tax exemption of \$11,400,000 per individual can be used during life or at death, and it does not need to be used all at once. Completed gifts using the exemption, along with their growth, are sheltered from future transfer taxes. Though the exemption may be used to transfer a variety of different assets (for example, cash, securities, real estate, life insurance, and closely held business interests), practitioners generally recommend gifting assets that are expected to appreciate significantly over time, thereby potentially increasing the tax-advantaged wealth transfer. Any assets that are not distributed to the beneficiary spouse remain in the trust and may continue to grow free of estate and gift taxes while remaining available for the next generation.

SLATs are taxed as grantor trusts for income tax purposes, which means the grantor bears the income tax burden on any trust earnings. This can be advantageous as it gives the trust the potential to grow without the encumbrance of income taxes, and the payment of those taxes by the grantor is not considered an additional gift.

Considerations When Forming a SLAT

SLATs require careful construction to help ensure maximum benefits and an understanding of the trust structure to help make certain it is appropriate given a couple's estate planning goals. Below is a list of factors and variables to consider when structuring a SLAT.

- **Trust must be irrevocable.** The grantor cannot retain any beneficial interest in the trust. As an irrevocable trust, the SLAT will not be included in the grantor's estate.
- **The trustee.** The donor spouse should not serve as trustee but a beneficiary spouse may, so long as the power to make distributions to him or herself is restricted by an "ascertainable standard." Ascertainable standards include a beneficiary's need for health, education, support, and maintenance. Either or both spouses (and current or future beneficiaries) can be given the ability to remove and replace a trustee.
- **The beneficiaries.** The primary beneficiary is the spouse of the donor. Children, grandchildren, and more remote descendants may also be named as either current or remainder beneficiaries. When the SLAT will continue beyond the lifetime of children, there are additional tax considerations that should be taken into account.¹

¹ Generation-skipping transfer taxes are imposed on gifts to grandchildren and more remote descendants. There is also a generation-skipping transfer tax exemption that may be utilized to better leverage such gifts. This topic is beyond the scope of this paper.

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- **Asset types.** As previously discussed, a SLAT can be funded with a variety of assets. However, it is important for the donor spouse to fund the SLAT with separate property only and not assets jointly owned with the beneficiary spouse. The risk of funding with a jointly owned asset is that the beneficiary spouse could be perceived as making a gift to the SLAT, which may result in the trust assets being includable in his or her estate, thereby, in effect, wasting the exemption allocated by the donor spouse. In community property states, the community nature of assets contributed to the trust must also be taken into account and likely severed.
- **Flexibility.** SLATs offer the unique opportunity to take advantage of utilizing one's gift and estate tax exemption while maintaining indirect access to those funds. To incorporate additional flexibility, the beneficiary spouse can be given a limited power of appointment within a SLAT. This power provides the ability to allocate trust assets in any manner to a limited class of recipients, generally the children in equal or unequal shares and with similar or different parameters. This is especially helpful in cases where children are too young for the parents to determine what their future needs will entail. With a limited power of appointment, the manner in which children will benefit can be outlined sometime after the trust is created.
- **Generating liquidity and improving growth potential.** If allowed by the trust document, and where there is no conflict of interest, there may be an opportunity to leverage assets in a SLAT as collateral against a custom portfolio line of credit. A trust may offer access to credit at a favorable interest rate to meet a near-term need (like generating cash for a new business investment) while maintaining a longer-term strategy (like investing in the market), thereby allowing the trustee to capitalize on new opportunities at a low cost while simultaneously retaining the trust's investments. For example, an investment portfolio in a SLAT can remain invested while the cash flow from any business interest owned by the SLAT covers payments on the loan. Additionally, the potential growth of a new business may contribute to the overall expansion of a SLAT's value. As long as the trust is structured and maintained correctly, all of these assets can be excluded from the donor's estate.
- **Divorce.** Divorce poses considerable risk to the functionality of a SLAT. Because one of the greatest utilities of a SLAT hinges on a spouse as a primary beneficiary, divorce has the effect of cutting off a donor spouse's, albeit indirect, access to the SLAT. If not carefully drafted, the trust can also result in the continued support of an estranged spouse. A potential safeguard would be to draft the SLAT so it is available only for any current spouse (and not former or estranged spouses). The SLAT can also be drafted to eliminate a spousal beneficiary completely in the event of divorce.

Best of Both Worlds

The outcome of every national election brings the possibility for new tax laws. A SLAT affords an estate plan the flexibility to adapt throughout one's lifetime while potentially maximizing gifting opportunities with the ability to transform in future financial and tax climates. While a SLAT may not be right for everyone, your Wells Fargo Relationship Manager, along with our team of experienced specialists and your legal and tax advisors, can help determine if this may be an appropriate strategy for you.

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