



Advice and Planning Update

Leveraging a Spousal Lifetime Access Trust

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Key Takeaways:

- The 2017 Tax Cuts and Jobs Act temporarily reduces the number of estates impacted by the estate tax, but with the automatic sunset of the law at the end of 2025, and proposed changes in legislation that may reduce the exemption sooner, estate planning should not be postponed.
- There are proposed changes to how grantor trusts, including SLATS, are treated for estate tax purposes. Because of potential legislation, timing of setting up a SLAT may be crucial.
- When structured and funded properly, any potential growth of the gifted assets within the SLAT is intended to be excluded from the beneficiary spouse's gross estate and to not be subject to estate tax when the beneficiary spouse dies.

What this may mean for you:

- Understanding the key features of SLATs can help you to determine whether taking advantage of this technique could reduce your potential estate tax burden in the future and ultimately pass more wealth to your heirs.

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While many prepare for their final life events by carefully constructing estate plans, changes in legislation can result in uncertainty and delayed planning due to potential tax law reform. The 2022 exemption is \$12,060,000; however, the longevity of this exemption is unknown. It sunsets on December 31, 2025, and could possibly be repealed or reduced sooner. 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 potential tax liability concerns; 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. 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.

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 families structure SLATs to permit distributions to the beneficiary spouse and children simultaneously. Additional trust parameters can be added as appropriate.

Potential tax advantages

The 2022 estate and gift tax exemption of \$12,060,000 per individual can be used during life or at death, and it does not need to be used all at once. 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), assets that may appreciate in the future would be optimal candidates for transfer. For example, if you transfer an asset worth \$1 million today to a SLAT, and in five years that asset grows to \$3 million, that appreciation is also outside of your taxable estate, even though you only used \$1 million of your exemption amount. If the assets in the SLAT are not distributed to the beneficiary spouse, they may continue to grow free of estate and gift taxes while remaining available for the next generation.

Alternatively, if you transfer an asset that depreciates in value over time, you may have “wasted” a portion of your gift and estate tax exemption through the transfer to a SLAT. Because of this concern, the donor spouse must carefully consider which asset would be an appropriate candidate for transfer.

Additionally, keep in mind that any transfer of assets out of your taxable estate would not gain the benefit of the “step-up” in basis that occurs when someone passes away holding an asset in their own name. This means that there could be a capital gain recognized when a trust sells an asset that would have been avoided if the asset had not been transferred to a trust. The cost-benefit analysis of saving estate taxes versus income taxes must be analyzed diligently for each individual.

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 income taxes, and the payment of those taxes by the grantor is not considered an additional gift. However, similar to potential reduction of the federal estate tax exemption, changes to how grantor trusts are treated for estate tax purposes is under consideration based on recent tax proposals. If you are considering enacting a SLAT at this time, continue to engage with your advisors to determine the viability of this strategy in light of potential tax legislation.

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.** A beneficiary spouse may serve as trustee, 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
- **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 partitioned.
- **Flexibility.** SLATs offer the opportunity to take advantage of utilizing the donor spouse's gift and estate tax exemption to shift assets out of the taxable estate, while still allowing the beneficiary spouse 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.
- **Divorce.** Divorce poses considerable risk to the functionality of a SLAT. You will no longer own or have direct access to the assets that you transfer 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). Your estate planning attorney can work with you on how to draft your SLAT to consider the potential for divorce.
- **Reciprocal Trust Doctrine.** When a married couple is creating two SLATs, one for the benefit of each spouse, the aspects of each trust must be carefully drafted to avoid the trusts being considered "reciprocal." If the trusts are too similar, so that the spouses are in the same economic position they were in before the SLATs were created, the estate tax benefit could be lost. Please consult with your legal and tax advisors before proceeding.

Conclusion

A SLAT affords an estate plan the flexibility to adapt throughout one's lifetime while potentially maximizing gifting opportunities. Your advisor along with your legal and tax advisors, can help determine if this may be an appropriate strategy for you.

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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