HARDING, SHYMANSKI & COMPANY, P.S.C.
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Leveraging a Spousal Lifetime Access Trust

The lifetime gift tax exemption is at an all-time high of $11.7 million per individual and $23.4 million per couple. However, under current law, these amounts are scheduled to decrease to $5 million per individual and $10 million per couple, indexed for inflation, after December 31, 2025. To increase tax revenue, the Biden administration is pushing to decrease the limits sooner than later. For this reason, wealthy couples may want to consider leveraging a Spousal Lifetime Access Trust, more commonly referred to as a SLAT, to take advantage of the current lifetime gift tax exemption.

What is a SLAT?

A SLAT is an irrevocable trust that a spouse establishes for use by their spouse, who is a beneficiary of the trust. Descendants such as children and grandchildren may also be included as beneficiaries. Once the donor spouse transfers assets to the SLAT, they lose legal ownership, control, and access to those assets. However, they may have access to or benefit from the assets indirectly through their spouse. SLATs allow spouses to access the funds immediately, even while the donor spouse is still alive.

Once a SLAT is established, the donor spouse transfers assets to the SLAT as a gift. The value of the transferred assets counts against the donor's lifetime gift tax exemption, and the transferred assets are then excluded from both spouse's estates for estate tax purposes.

Current Guidance

Even though the current lifetime gift tax exemption amounts are scheduled to sunset by 2026, taxpayers can utilize the full exemption without fear of clawbacks. The Treasury Department confirmed that taxpayers who use the current lifetime gift tax exemption amount will not be adversely affected when the exemption amount reverts back to $5 million, indexed for inflation, in 2026. Basically, taxpayers will not face a future clawback if they have taken advantage of the current lifetime gift tax exemption limit even though it's scheduled to decrease in the future.

Reciprocal Trust Doctrine

SLATs can be a powerful estate planning tool, and it is not uncommon for each spouse to create a SLAT for the other. However, it's important not to violate the "reciprocal trust doctrine." On a very basic level, the two SLATs must be sufficiently different from one another; otherwise, the IRS can ignore the irrevocability of the trusts and pull assets back into the spouses' estate for federal estate tax purposes.

SLAT Requirements

When transferring assets to a SLAT, the assets must be owned individually by the donor spouse and not be joint assets. If couples have joint assets, they will have to be converted to individually owned assets and timed adequately to avoid the IRS's "step transaction doctrine." Otherwise, the IRS may take the position that a spouse transferred an asset to an irrevocable trust to which they are a beneficiary.

Considerations

One thing to consider is that a SLAT is a grantor trust, and as such, the donor spouse pays tax on any income generated by the assets in the trust. If an asset is sold and results in a significant capital gain, the donor spouse will realize the capital gain on their personal tax return. Since the donor spouse has no actual ownership over the trust's assets, they may not have the financial ability to pay the taxes owed.

Another thing to consider is that a SLAT is irrevocable. It cannot be altered nor amended, so if a couple gets divorced, the ex-spouse will continue to be the beneficiary. Further, as grantor by law, the donor spouse would have to pay income taxes on any trust earnings that benefits their former spouse.

Final Thoughts

With potential changes to the lifetime gift tax exemption, it's a good idea to review your estate plan. This document is only meant to provide an overview of a SLAT and is not a substitute for speaking with our advisors. If you would like to learn more about SLATs and discuss your unique situation, please contact our office.

About Harding, Shymanski & Co.

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