Would You Benefit from a SLAT?

Consider the Spousal Lifetime Access Trust

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Despite favorable changes under the American Taxpayer Relief Act of 2012 (ATRA), comprehensive estate planning remains a challenge. However, a relatively simple technique, called the spousal lifetime access trust (SLAT), may be advantageous for your situation. SLATs have proven to be especially popular among those who have remarried and want to protect children from a prior marriage.

Background: As the name implies, a SLAT is an irrevocable trust essentially established for the benefit of a living spouse, with the remainder going to heirs such as your children and grandchildren. Although the transfer of assets used to fund the trust is treated as a taxable gift, any gift-tax liability may be avoided or reduced with proper planning. In doing so, those assets will be removed from your taxable estate. In addition, a SLAT offers protection from creditors or an ex-spouse who is trying to reach your assets.

Generally, distributions are made to your spouse during his or her lifetime as needed. To preserve a larger nest egg for your heirs, you may choose to use funds outside the trust first for this purpose.

What are the main tax consequences from this arrangement? The transfer of assets can be sheltered from gift tax by the lifetime gift-tax exemption (although this erodes the grantor's available estate-tax shelter). Under ATRA, the exemption is a lofty $5 million (inflation-indexed to $5.25 million in 2013), so most individuals should have plenty of room to maneuver.

What's more, the SLAT is considered to be a "grantor trust" for income tax purposes. That means a couple must pay tax on the earnings on their personal tax return, but the assets can continue to grow inside the trust without any tax reduction. When the grantor dies, the trust is required to pay income tax.

Be aware that the grantor will be required to file a gift-tax return with the IRS. With professional assistance, you can structure the trust to take advantage of the $5.25 million lifetime exemption.

Finally, the assets included in the SLAT are not subject to federal estate tax. But there is a potential estate-tax complication to consider. Frequently, a couple will establish a SLAT to benefit one another, even if one spouse is significantly younger than the other. In that way, protection is ensured should the younger spouse predecease the older spouse. Under special tax rules, so-called "reciprocal trusts" must be different in a meaningful way. If they are identical, the assets will be included in the taxable estate of the grantor. This result may be avoided by setting up SLATs at varying times, employing different terms and funding the trusts separately.

Other planning aspects may come into play. For example, if you set up a SLAT and then get divorced, you will lose access to the assets you have transferred to the trust. Remember that the trust is irrevocable, so you cannot call back the assets for any reason whatsoever.

It's not for everyone: Before you commit to a SLAT, consider all the factors to decide if this technique is appropriate for your situation. Your Henry & Horne, LLP tax- and estate-planning advisers can help steer you in the right direction.

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