

SPOUSAL LIFETIME ACCESS TRUST (SLAT)

(SPOUSE AND CHILDREN AS BENEFICIARIES) (LIFE INSURANCE POLICY OR SPLIT DOLLAR INTEREST)

[See the Estate Planning Summary of the American Taxpayer Relief Act of 2012 (TRA 2012) and Federal Estate and Gift Tax Rates and Credits documents in the Special Files section of DOD for a summary of estate planning changes contained in TRA 2012, including the inflation-adjusted amounts, which became effective on 1/1/2013. TRA 2012 reunifies the gift, estate, and GST tax exclusion amounts at an inflation-adjusted \$5,000,000 with a maximum tax rate of 40%. It also enables a surviving spouse to use any exclusion amounts that were not used by his or her deceased spouse. See also, the Tax Planning after the Tax Cuts and Jobs Act of 2017 document in the Special Files section of DOD for additional estate and pension planning updates.]

HIGHLIGHTS OF THE PLAN

A Spousal Lifetime Access Trust (SLAT) is an irrevocable trust that is designed to provide the Grantor/Insured the benefits of wealth accumulation, access to Trust assets through spousal receipt of income, withdrawals or loans, and asset protection from creditors of the Grantor and Trust beneficiaries. These Trusts are often funded with a combination of life insurance and other assets.

To remove assets, including life insurance proceeds, from the Grantor's estate for estate and generation-skipping tax purposes, the Grantor has to irrevocably give the assets (or policy) to a third party, such as an irrevocable trust. When life insurance is the sole or primary asset in such a trust the trust is called an irrevocable life insurance trust.

The main reason that many people are reluctant to establish an irrevocable trust, including a Spousal Lifetime Access Trust (SLAT), is the loss of control over trust assets. A SLAT enables the Grantor/Insured's spouse to access trust assets through receipt of income or withdrawals or through a series of demand loans that are secured by property pledged by the borrower, with interest payable at a fair market rate at least equal to the applicable federal rate for demand loans. The loan interest in these arrangements is often accrued rather than paid in cash.

During the lifetime of the Grantor/Insured, the trustee or a co-trustee of the Trust is often the spouse of the insured, unless a survivorship (2nd-to-die) policy is owned by the trust, in which case a child or other family member is the trustee or co-trustee. A corporate trustee is often used after the death of the insured or insureds and may be used during the lifetime of the insured as long as the spouse or other family member trustee has the discretionary authority to make loans or otherwise make distributions of income and/or principal from the trust.

A properly drafted SLAT will not:

- Afford the Grantor/Insured a beneficial interest in the trust,
- Allow the Grantor/Insured to replace the Trustee with himself/herself,
- Give the Grantor/Insured any incident of ownership in the trust-owned insurance policy.

ASSET PROTECTION

Most states permit beneficiaries of a Trust established by another person to be free from the claims of the beneficiaries' creditors. The provision in a Trust that creates this type of asset protection is called a “spendthrift” clause. However, if a person sets up a Trust for his or her own benefit (a self-settled Trust), the creditors of the Grantor/Settlor can generally attach assets in the Trust to satisfy a judgment. Certain states, such as Alaska, Connecticut, Delaware, Hawaii, Indiana, Michigan, Missouri, Mississippi, Nevada, New Hampshire, Ohio, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Virginia, West Virginia, and Wyoming, permit spendthrift protection even for a self-settled Trust where all state requirements are met.

The various state domestic asset protection laws differ as to: (1) the statute of limitation period – the time during which a creditor's claim is valid; (2) which creditors, such as divorcing spouses, may be exempt; and (3) what is considered a fraudulent conveyance.

LOANS TO GRANTOR'S SPOUSE

One version of the trust gives the Grantor/Insured's spouse the right to borrow from the trust, provided he/she executes a demand note secured by other property owned by the Grantor/Insured and pays interest (usually accrued) at a fair market rate at least equal to the applicable federal rate for demand loans the trustee makes from policies or other assets owned by the trust. A more conservative version of the Trust would permit such loans only at the discretion of the (non-spouse) trustee. In any event, the spouse's right to borrow from the trust should be subject to the trustee's power to prohibit any loan that would cause the underlying life insurance policy to lapse or not extend to maturity.

One of the major benefits of the Trust is that when the cumulative loan and accrued interest is paid back to the Trust from the spouse's estate, the loan and accrued interest payment is deductible from the spouse's estate as a bona fide debt. For example, if the cumulative loan, including interest, is \$1,000,000, the estate will be entitled to deduct the full \$1,000,000. The effect of this deductible loan and accrued interest payment is to transfer a substantial portion of the decedent's estate to the Trust transfer tax free.

The spouse or family member trustee may be given the power to “sprinkle” income and principal among certain of the beneficiaries. Where the spouse is a trustee and an income beneficiary of the trust, the spouse's right to make distributions to trust beneficiaries must be limited to an ascertainable standard (i.e., health, education, maintenance, and support) when making distributions to himself/herself. In any event, the trust should not permit the Grantor or the spouse from relieving himself or herself from any support obligation imposed by law.

The trustee is also given the power to use trust assets to buy houses or businesses for use by

beneficiaries, purchase insurance on the lives or health of beneficiaries, pay for educational expenses, and, after the Grantor/Insured's death, make demand loans to other beneficiaries in addition to the spouse.

LIMITED POWER OF APPOINTMENT

It may be possible to structure the Trust so that the Grantor/Insured can access trust assets through use of a limited power of appointment held by another person, such as the spouse or other family member. Access could be accomplished if the Trust has a provision naming a limited power holder who, during the lifetime of the Grantor(s), has the right to move trust assets to a successor trust. If the limited power holder so chooses, the successor trust could have provisions which provide support for the Grantor/Insured, or it could even be a revocable life insurance trust which could provide the Grantor/Insured with access to the trust's assets. If the limited power holder selects either approach under the limited power, any subsequent policy death benefits would be included in the estate of the Grantor/Insured; however, this is hardly an issue if the Grantor/Insured is in need of the money later in life. There is not direct authority for the transfer of trust assets in this fashion, and the suitability of this strategy for a particular client must be determined by client's counsel on a case-by-case basis; however, even very conservative clients may wish to include the enabling language in their trust in case the feature becomes desirable at a later date.

DISTRIBUTIONS AFTER GRANTOR'S DEATH

After the Grantor's death, life insurance policy proceeds will be paid into the Trust, which is designed to benefit the Grantor's spouse then distribute the remainder to the children or other descendants, keeping assets in trust for beneficiaries who are minors. Trust assets can be used to provide for education and medical expenses, support and maintenance expenses, money for home purchases, funding for starting or operating a business, or other family needs.

No Generation-Skipping Provisions in this Document Set: The specimen agreement for this SLAT document set is designed to distribute assets to adult children relatively soon after the death of the survivor of the Grantor/Insured or the Grantor/Insured/s spouse and does not contain generation-skipping trust provisions.

Important Note: This material is for educational purposes only. In all cases, the approval of a client's legal and tax advisers must be secured regarding the implementation or modification of any planning technique as well as the applicability and consequences of new cases, rulings, or legislation upon existing or impending plans.