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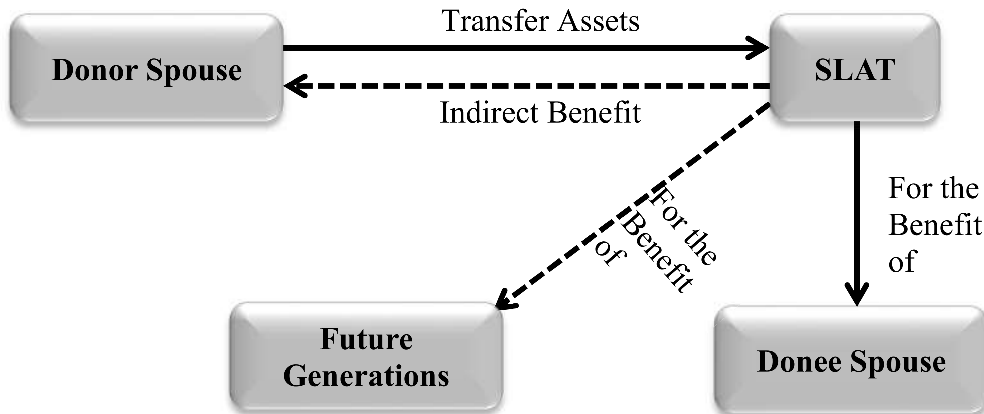
# #25: Spousal Limited Access Trusts

A spousal limited access trust (SLAT) is an irrevocable trust established by one spouse (the "Donor Spouse") for the benefit of the other spouse (the "Donee Spouse"), with the remainder interest passing to the couple's children and grandchildren when the donee spouse dies. Creating a SLAT may be a good way to take advantage of the relatively high current applicable exclusion amount ($13,610,000 in 2024) and remove substantial amounts of appreciation from the gross estate while indirectly retaining the ability to access the funds if necessary through distributions to the spouse.




The transfer of assets by the donor spouse to establish the trust is considered a gift and will use some or all of the donor spouse's gift tax applicable exclusion amount. Any amount up to the exemption amount and any future appreciation of that amount in the SLAT will eventually pass estate tax-free to the donor spouse's children, grandchildren, or future generations.

At the same time, however, the SLAT is set up to allow for distributions to the donee spouse to meet his or her needs and, indirectly, those of the donor spouse.

> ***Example 1***. Donor spouse wishes to make a gift of $13,610,000 to use his entire gift tax exemption in 2024. However, donor spouse also worries about making such a large gift all at once. What if the market crashes and donor spouse needs those funds in the future? Donor spouse could create a SLAT for his wife's benefit and transfer the $13,610,000 to the trust. The SLAT could provide distributions to donee spouse for her needs and their children's needs.

The tax savings produced by making a lifetime transfer could be quite dramatic as shown in the following example.

> ***Example 2.*** Ron and Betty are married taxpayers with a large estate they plan to leave to their children. They each own a $13,610,000 investment account they plan to leave to their children. Ron and Betty do not feel comfortable giving away any of the assets outright. Because a SLAT enables them to access trust income and

principal, however, they are willing to create SLATs for each other immediately.[84] The following illustration compares the tax results of creating the two SLATs now with the tax results of dying with the investment accounts. To keep the analysis as straightforward as possible, assume that the applicable exclusion amount stays at $13,610,000 for the next 10 years. Further assume a growth rate of 5% and an estate and gift tax rate of 40%.

> Scenario 1—Create Two SLATs Now: In Year 1, Ron sets up a SLAT for Betty and Betty sets up a SLAT for Ron. In both cases the remainder interest passes to the children. They take advantage of their entire lifetime exemption amounts and transfer the full $27,220,000 value of the investment accounts to the SLATs. The SLAT assets grow at 5% per year. In Year 10, both Ron and Betty die. There is no tax in Year 1 because the spouses' applicable exclusion amounts completely cover the gifts. In Year 10, the Year 1 transfers are included in their respective estates as adjusted taxable gifts, but the full value is covered by the applicable exclusion amount. Thus, by creating two SLATs, Ron and Betty can transfer their full estate with no transfer tax.

| | |
|---|---:|
| Year 1 SLATs | $27,220,000 |
| FMV of SLATs @ Year 10 | $44,338,512 |
| Taxable Amt. | $0 |
| Estate Tax Payable | $0 |
| Total Value Transferred | $44,338,912 |

> Scenario 2—Dying with the Investment Accounts: Ron and Betty never set up a SLAT and die with the investment accounts. The tax consequences are shown in the following chart.

| | |
|---|---:|
| Year 1 Inv. Accts. | $27,220.000 |
| FMV of Inv. Acct. @ Year 10 | $44,338,512 |
| Estate AEA | $27,220,000 |
| Taxable Amt. | $17,118,512 |
| Estate Tax Payable | $6,847,405 |
| Total Value Transferred | $37,491,107 |

> Thus, by creating SLATs, Ron and Betty save $6,847,405 in estate tax. Instead of locking in the tax value of the assets in Year 1 at $27,220,000, $17,118,512 of growth was included in their gross estates in Scenario 1, increasing the tax payable by $6,847,405 (.4 x $17,118,512).

For income tax purposes, a SLAT is usually considered a grantor trust. This means that the donor spouse will report the trust's taxable income and deductions on his or her personal income tax return. This allows the SLAT assets to grow at their pre-tax rate of return, increasing the amount that will transfer tax-free to the children at the end of the trust term. However, grantor trust status could create

[84] Note the cautions about avoiding the reciprocal trust doctrine at the end of this topic.

a cash flow problem for the donor spouse because he is paying tax on income he is not receiving. If the trust is created in a state that permits domestic asset protection trusts (DAPTs), this problem can be addressed by giving the trustee discretion to reimburse the donor for the tax paid.

However, if funds are available outside of the trust, it is generally advisable to use those funds first rather than making distributions out of the SLAT to the donee spouse. Any amount taken out of the SLAT brings assets back into the parents' estate, reducing its value and thus, its effectiveness for transferring wealth tax-free to future generations. The next example illustrates the negative effect of tax reimbursements and distributions to the spouse on the amount of the tax-free transfer.

> ***Example 3.*** Let's suppose that donor sets up a SLAT for the benefit of his spouse, with the remainder to his children. Donor has $5,340,000 of applicable exclusion amount remaining and transfers this amount to the SLAT, incurring no gift tax. The entire amount left in the trust after the donee's death (i.e., the donor's spouse's death) will pass estate tax-free to the donor's children. Assume that the donor dies 20 years later and that the trust assets grow at 6% per year.
>
> The table below shows the amount passing tax-free to the children at the end of 20 years in each of the four scenarios. In Scenario 1, the donor pays the taxes himself, with no reimbursement, and no distributions are made to the spouse. In Scenario 2, the donor is reimbursed by the trustee for the taxes he paid (assume a 23.8% tax rate) but there are no distributions made to the spouse. In Scenario 3, the donor pays the taxes himself, with no reimbursement, but there are distributions made to the spouse (assume 50% of trust income is paid to the spouse). In Scenario 4, the donor is reimbursed by the trustee for the taxes he paid (23.8% tax rate) and distributions are made to the spouse (50% of trust income). Note that the lower the distributions, the larger the transfer to the children.

| | **Scenario 1** | **Scenario 2** | **Scenario 3** | **Scenario 4** |
|---|---:|---:|---:|---:|
| Total Value after 20 Years | $17,126,103 | $13,127,286 | $9,644,634 | $8,398,560 |
| Total Increase in Value after 20 Years | $11,786,103 | $7,787,286 | $4,304,634 | $3,058,560 |
| Total Return over 20 Years | 220.71% | 145.83% | 80.61% | 57.28% |
| Compounded Rate of Return Per Year | 6.0% | 4.6% | 3.0% | 2.29% |

Possible Limitations

There are some issues that one must consider before jumping into a SLAT though. Since the SLAT will be set up for the benefit of the donor's spouse, and thus, only indirectly benefiting the donor if the spouse takes a distribution, the donor loses access to the trust when the spouse dies and perhaps also if there is a divorce. Therefore, it is best to only put those funds in the SLAT that the donor can reasonably expect to do without. Another way to avoid this issue is to have both couples set up a SLAT for each other's benefit; i.e., husband sets up a SLAT for wife and wife sets up a SLAT for husband. This would also enable the spouses to take advantage of both $12,920,000 exclusion amounts.

If the spouses create two trusts, however, they must plan carefully to avoid the reciprocal trust doctrine. In *United States v. Estate of Grace*,[85] a husband created a trust for his wife and the wife created an identical trust for the benefit of her husband. Because neither spouse retained an interest in the trust that spouse created, IRC § 2036 didn't apply. However, because the trusts were interrelated and left the settlors in approximately the same position they would have been in if they had created trusts for themselves, the court uncrossed the trusts, treating the husband as the settlor of the trust for his benefit and the wife as the settlor of the trust for her benefit. Thus, IRC § 2036 applied to both trusts, making the transferred assets includible in the transferors' gross estates.

It appears it is possible to avoid the reciprocal trust doctrine if the trusts created by the spouses are sufficiently different from each other. For example, in *Estate of Herbert Levy,*[86] the Tax Court refused to uncross trusts created for each other by spouses because the husband's trust gave the wife a special power of appointment over the trust assets, while the wife's trust did not confer such a power on the husband. Commentators have suggested that the reciprocal trust doctrine might also be avoided by having the trusts be created at different times, including different remainder beneficiaries or giving the donee spouses different powers over the trust assets.[87]

Since the assets transferred to the SLAT are a gift, a gift tax return must be filed. Furthermore, since the spouse is a beneficiary of the trust, gifts to the SLAT are usually not eligible for gift-splitting, so one-half of the gift cannot be reported by each spouse. Therefore, plan on only funding the trust with an amount up to or less than the donor's available gift and estate exemption. Lastly, before setting up a SLAT, there are some important drafting techniques that must be researched and considered.

Disclosures

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[85] 395 US 316 (1969).
[86] TC Memo 1983-453.
[87] Peterson, Lori. "Make Use of the Gift Tax Exemption With Spousal Access Trusts." May 2013.