

TAX, ESTATE PLANNING & PERSONAL WEALTH ALERT

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Using SLATs to take advantage of estate tax exemption

For high net-worth families, a window of opportunity to save a significant amount of estate tax may be closing sooner than expected. For married persons, a Spousal Lifetime Access Trust (SLAT) could be a particularly useful tool in the right circumstances.

The current status of estate tax law

The Tax Cuts and Jobs Act passed during the Trump administration effectively doubled the previous estate tax exemption as of Jan. 1, 2018. As a result, the current estate tax exemption is \$11.7 million per person, reduced by any prior taxable gifts and indexed annually for inflation. The doubling of the estate tax exemption was not permanent when enacted. The current law states that this exemption level will be cut in half after Dec. 31, 2025. There are also current Congressional proposals that seek to accelerate this reduction as early as Jan. 1, 2022. If that were to happen, taking into account anticipated inflation indexing, the per person estate tax exemption amount would be roughly \$6 million in 2022, rather than roughly \$12 million.

The potential halving of the current estate tax exemption creates a possible *use it or lose it* scenario. This is due to how one's taxable estate is calculated at the time of death. Essentially, to maximize the benefit from the current exemption prior to its halving, the taxpayer would use as much as, or close to, their remaining estate and gift tax exemption amount.

For example, assume a taxpayer has made no prior taxable gifts, makes gifts near the end of 2021 and the exemption is cut in half beginning on Jan. 1, 2022. If the taxpayer has a \$20 million estate and makes a gift of \$11.7 million in 2021, the taxpayer will have removed \$11.7 million plus

any subsequent appreciation thereon from the taxpayer's taxable estate. Having fully used the exemption (ignoring inflation adjustments), the taxpayer would be subject to estate tax on the remaining \$8.3 million. Assuming the taxpayer dies in 2022 and the estate tax rate remains 40%, that would result in an estate tax of \$3.32 million. However, if the taxpayer only gifted \$5.85 million in 2021, then the taxpayer would have only removed \$5.85 million plus any subsequent appreciation thereon from the taxpayer's taxable estate. The taxpayer would still have no exemption remaining in 2022 (ignoring inflation adjustments), but the remaining taxable estate would be \$14.15 million. The resulting estate tax would be \$5.66 million at the time of death, costing the taxpayer's estate an additional \$2.34 million in estate taxes. Thus, the taxpayer who used \$5.85 million or less in exemption before 2022 would receive no benefit from the current temporary exemption levels. The failure to take advantage of the current exemption level is an opportunity cost of removing up to an additional \$5.85 million plus any subsequent appreciation thereon out of one's estate on a tax free basis. With estate tax rates at a current flat 40%, this opportunity cost could be the difference in millions of dollars of estate taxes saved.

SLATs as a technique to use increased exemption while granting a spouse a beneficial interest

Given the very large amounts that must be gifted to truly take advantage of this temporarily doubled exemption, many taxpayers are reluctant to make such a gift because they generally may not have a beneficial interest in the gifted property. Many others are reluctant to irrevocably transfer such a sizeable amount of assets to or for the benefit of children at this time. If the taxpayer is married, gifting to a SLAT utilizes the current exemption but allows the taxpayer's spouse to benefit or potentially benefit from the gifted property. A SLAT is an irrevocable trust in which one spouse (the grantor) gifts property to a trust they create and their spouse is a beneficiary of that trust but does not hold powers which would include that property in the beneficiary spouse's estate for estate tax purposes.

A SLAT can be very flexible with respect to how it is structured. For example, if drafted properly, the beneficiary spouse could even serve as trustee of the SLAT while at the same time being a beneficiary. A SLAT could be structured so that the grantor's spouse is the only current beneficiary during the spouse's lifetime or is one of a class of several current beneficiaries (for example, the grantor's spouse and descendants could all be current beneficiaries during the spouse's lifetime). At the beneficiary spouse's death, the assets in the SLAT would generally remain in trust for the grantor's children and descendants (often dividing into separate trusts for each child). If the grantor desires to provide the beneficiary spouse with this power, the beneficiary spouse could be given a limited testamentary power of appointment to, if exercised in the beneficiary's spouse's will, modify the terms of the trust for the grantor's descendants or change the percentage of trust assets that would pass for the benefit of each child.

Planning considerations in utilizing SLATs

While married taxpayers are often attracted to SLATs as a vehicle for removing assets from the estate of the grantor, there are issues which must be closely analyzed and considered by the grantor in structuring a SLAT. First, the grantor can retain no beneficial interest in the SLAT. Therefore, if the beneficiary spouse dies first, the assets are held in trust for the remainder beneficiaries (typically children and descendants). A financial analysis of the grantor's life expectancy, assets other than those that would be transferred to the SLAT, and potential inheritance of assets owned by the grantor's spouse if the grantor's spouse dies first should be undertaken to ensure that the grantor and the grantor's financial advisor are comfortable that there is not a material risk of the SLAT transfer causing the grantor to run out of money or otherwise affect the grantor's lifestyle.

The possibility of divorce is also an issue that should be met head on by the grantor in considering how to structure the SLAT. Because the SLAT is not includible in the beneficiary spouse's estate and is not intended to qualify for the marital deduction, the grantor can provide in the SLAT that the spouse's beneficial interest terminates on the occurrence of an event (such as a divorce). If structured in that way, a divorce would be treated similarly to a death of a beneficiary spouse in that the SLAT assets would be held in trust for the remainder beneficiaries (typically the grantor's children and descendants) and the beneficiary spouse's interest would terminate. Another way to structure a SLAT to plan for a potential divorce and remarriage by the grantor is to define *spouse* in the trust as the person to whom the grantor is married from time to time. Using this definition, a divorce would terminate the initial beneficiary spouse's interest and, if the grantor later remarries, the grantor's new spouse would become a beneficiary of the SLAT. In long marriages with children of the same union, some grantors are comfortable with divorce risk and do not provide for any contingencies with respect to potential divorce. The decision is a personal one that should be evaluated by each grantor.

SLATs are certainly not cookie-cutter documents that can be prepared without thought, care and consultation. There are many structural decisions about which the estate planning attorney will consult with the grantor. Because a SLAT must be an irrevocable trust to obtain the estate tax benefits, the grantor's wishes as to several components of the SLAT should be discussed and carefully evaluated.

Timing consideration relating to SLATs

SLATs are typically structured as *grantor trusts* for income tax purposes. While it may be possible to structure them otherwise, most prefer the grantor trust structure for various reasons. As a part of its budget reconciliation proposal submitted on Sept. 12, 2021, the House Ways and Means Committee has proposed, in addition to cutting the estate tax exemption in half effective Jan. 1, 2022, eliminating the ability to structure grantor trusts so that they may be kept outside of a taxpayer's taxable estate. The contemplated effective date of this proposal with respect to

grantor trusts would be the date of enactment of the law (e.g., if passed, the day the president signs the bill into law). That date could be earlier than Jan. 1, 2022. Therefore, if taxpayers wish to take advantage of the temporarily increased exemption by using SLATs, and if the House Ways and Means Committee proposal is passed, the window for using the SLAT technique in its current form may close soon. Therefore, it is imperative that taxpayers who are interested in exploring whether a SLAT would be a beneficial planning technique take action as soon as possible.

For more information please contact [Mark Noel](#), [Peter Slater](#) or any member of Porter Wright's [Tax, Estate Planning & Personal Wealth practice group](#).