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Spousal Lifetime Access Trusts (SLATs)

An Important Tool for Married Couples

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Summary

Although we all know the golden rule ("she who owns the gold, rules") even applies in families, some may feel sufficiently confident in their spouses that they will risk transferring assets to their spouses to protect the property from claims of creditors. As long as there is no fraudulent transfer involved, one spouse may transfer assets to a trust for the benefit of the other spouse, and protect the wealth in its entirety (assuming the trust is created in a jurisdiction that protects trusts under its spendthrift laws). This also will prevent the trust assets from being included in the gross estate of the transferor spouse and the gross estate of the beneficiary spouse, unless that spouse has a general power of appointment described in Section 2514 and 2041 (or the trust was a so-called QTIP trust, described in Section 2523[f][1]). It seems that the assets avoid inclusion in the estate of the transferor spouse unless the trust mandates the use of the trust property to discharge the obligation of the transferor to support his or her spouse.[2]

Benefits of a SLAT

By creating a trust for one's spouse, a property owner can continue to benefit from the property through the spouse without concern of creditor claims or estate tax inclusion.[3] Although the trust could be made to qualify for the gift tax marital deduction (provided the beneficiary spouse is a US citizen), this should not be done to avoid its inclusion in the gross estate of the beneficiary spouse, thereby using the transferor spouse's gift tax exemption.

> *"By creating a trust for one's spouse, a property owner can continue to benefit from the property through the spouse without concern of creditor claims or estate tax inclusion."*

In fact, if the beneficiary spouse has a power of appointment (or is later granted one by a decanting or otherwise[4]), he or she could exercise it in favor of a trust for the transferor spouse. Additionally, unless the IRS (or a creditor perhaps) could show an understanding that the beneficiary spouse would so exercise it in such a manner, it would seem there should be no inclusion in the gross estate of the surviving spouse.[5] Nonetheless, it would be prudent

to have the beneficiary spouse create the trust for the transferor spouse in a jurisdiction that would protect the trust from the claims of the transferor spouse's creditors. [6]

Avoiding the Reciprocal Trust Doctrine

The matter becomes, in some ways, more complicated if each spouse creates a trust for the other. This raises the risk of application of the so-called "reciprocal trust" doctrine, under which each beneficiary is treated as creating the trust for him or herself, potentially increasing the risk of estate tax inclusion (and claims of creditors).[7] The parameters of how different the trusts for the spouses, or the amounts involved, must be, to avoid the doctrine, have not been determined. Although one case[8] held that the doctrine did not apply where one spouse gave a lifetime special power of appointment to the other, where no power of appointment was granted to the other, it has been recommended the trusts be created at different times, with different trustees, with different assets and under the laws of different jurisdictions, among other differences.[9] In fact, it may be best if one spouse creates a trust for the other spouse and delays even advising the beneficiary spouse of the creation of the trust, much less having two created at the same time, to reduce the risk of any claim of an implied understanding.[10] Moreover, it would be best to create the trust in a domestic-asset-protection trust jurisdiction, such as Alaska or Nevada, because, if the decedent is a mere discretionary beneficiary with no power to control the beneficial enjoyment of the property, there should be no estate tax inclusion (provided the creditors of the beneficiary cannot attach the trust assets).[11]

SLATs are Grantor Trusts

A factor that likely should be kept in mind when creating a SLAT is that the trust probably will be a grantor trust as to the spouse who created the trust. That, of course, means that all tax income earned in the trust will be taxed to that spouse. That will prevent the trust from avoiding state income tax if the grantor spouse is a resident of a state that imposes an income tax.

> *"If a grantor trust is to be avoided, distributions can be made payable to the beneficiary spouse only with the consent of an adverse party."*

If a grantor trust is to be avoided, distributions can be made payable to the beneficiary spouse only with the consent of an adverse party. Another factor about grantor trust status is that even if the spouses divorce, the spouse who created the trust will continue to be taxed on the trust income. Therefore, the trust probably should have a provision eliminating the spouse as a beneficiary if the spouses divorce or allowing distributions to the former spouse only with the consent of an adverse party.

Endnotes

1 See Section 2044. Section refers to a section of the Internal Revenue Code of 1986, as amended.

2 See discussion in Gans & Blattmachr, "Another Look at Spousal Lifetime Access Trusts," Leimberg Estate Planning Newsletter 1387 (December 18, 2008); but cf. Merrick & Goodwin, "The Good, Bad and Ugly of Spousal Access Trusts," Leimberg Estate Planning Newsletter 1334 (Aug. 20, 2008).

3 See Gutchess v. Commissioner, 46 T.C. 554 (1966), acq. 1967-1 CB 2.

4 Zeydel & Blattmachr, "Tax Effects of Decanting-Obtaining and Preserving the Benefits," 111 Journal of Taxation 288. (Nov. 2009).

5 Cf. Rev. Rul. 2004-64, supra.

6 See Rothchild et al., "IRS Rules Self-Settled Alaska Trust Will Not Be Grantor's Estate," 37 Estate Planning 3 (Jan. 2010).

7 See Slade. "The Evolution of the Reciprocal Trust Doctrine Since Grace and Its Application in Current Estate Planning," Tax Mgt Estates, Gifts & Trusts. (May 1992); Steiner & Shenkman, "Beware of the Reciprocal Trust Doctrine," Trusts & Estates 14 (2012).

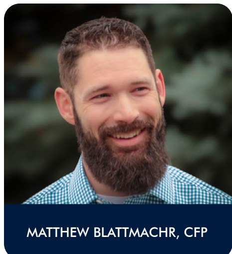
8 Estate of Levy v. Commissioner, T.C. Memo 1983-453.

9 See suggestions in Blattmachr, Gans & Zeydel, "Supercharged Credit Shelter Trust[sm]," 21 Probate & Property 52 (Jul./Aug. 2007).

10 The reciprocal trust doctrine was developed under common law and later applied to the tax law. See De Rousse v. Williams, 181 Iowa 379 (1917), and Everett v. Peyton, 167 NY 117 (1901). Lehman v. Commissioner, 109 F2d 99 (2d Cir. 1940), cert. denied, 310 U.S. 637 (1940).

11 See PLR 2009-44-002 (not precedent) discussed in Rothchild, note 6, above.

About the Authors



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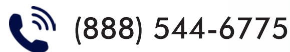

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