Wealth Transfer Strategies

The Spousal Lifetime Access Trust

The Estate Tax – A Moving Target

The current federal estate tax originated from tax laws passed in 1916 and has gone through a constant stream of changes over the past few decades. There have been attempts to repeal the tax, changes to the exemption amount and tax rates, and there was even a year without an estate tax (2010) that turned into a year with a retroactive estate tax. On December 17th, 2010 the President signed into law the Tax Relief, Unemployment Insurance Reauthorization, and Jobs Creation Act of 2010 which contained dramatic, yet temporary, changes to the federal transfer tax system (estate, gift and generation skipping taxes). Considering the fact that this tax is a moving target that is levied at a point in time that is itself uncertain (the year of death), two basic concepts should drive planning for the estate tax in the future – flexibility and risk management. There are many strategies that are designed to protect families from the risk of a future estate tax while retaining a level of flexibility. One such solution is the Spousal Lifetime Access Trust.

Creating a Flexible Solution

An irrevocable life insurance trust (ILIT) is an effective estate planning tool for creating liquidity in an estate without creating additional estate tax exposure. Married couples create ILITs to replace income in the event of an untimely death, pay estate taxes and administration expenses, and equalize inheritances among children. However, these trusts are often criticized as inflexible. A common complaint is that both husband and wife lose access to the life insurance policy's cash value while they are alive.

One possible solution is to create a Spousal Lifetime Access Trust (SLAT). In this strategy a survivorship ILIT owns and is the beneficiary of survivorship life insurance (also known as "second-to-die"), typically covering a husband and wife. It is designed to provide liquidity for estate taxes and administration expenses after the surviving spouse's death. This trust design is popular because survivorship life insurance is ordinarily less expensive than single life coverage and, with proper planning, most estate taxes will not be due until the death of the surviving spouse.

Traditionally, the belief has been that one of the insureds cannot be the beneficiary of an ILIT holding a survivorship policy. In such a trust, if the IRS finds that either spouse held any "incidents of ownership", it would subject the life insurance death proceeds to federal estate taxes. The general understanding is that neither insured spouse could benefit in any way from a survivorship trust. However, by using a special type of survivorship ILIT, it is possible for one spouse to have access to the cash values during his or her life. The SLAT is particularly effective when flexibility is a goal.

How the Survivorship SLAT Works

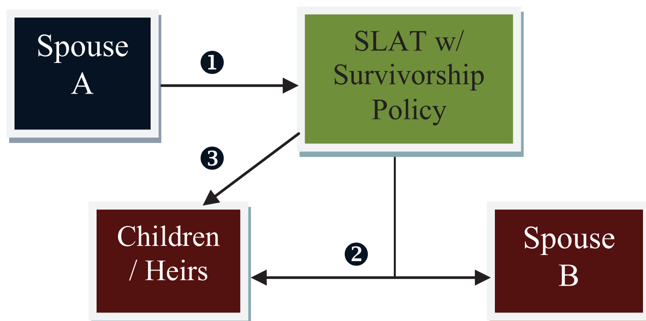
Two IRS private letter rulings, PLR 9451053 and PLR 9748029, are helpful in illustrating how to design and create a Survivorship SLAT.

The Survivorship SLAT must be established by just one spouse. The grantor spouse is typically the one more likely to die first. The other spouse (the non-grantor spouse) is the primary beneficiary. In each of the two PLRs the non-grantor spouse's beneficial interest was sufficiently restricted so as not to be

considered an incident of ownership. The non-grantor spouse can be given the right to receive distributions subject to an "ascertainable standard," such as "health, education, maintenance, and support," without causing estate tax inclusion. Another way to provide income to the beneficiary / spouse is to make distributions solely within the discretion of an independent trustee.

The trust should be the applicant, owner and beneficiary of all life insurance policies. If the policy is applied for and owned by the trust from inception, the death proceeds should be excluded from the gross estate, provided the purchase of the insurance was at the discretion of the trustee.

The grantor spouse makes all the actual transfers of property to the trust. The non-grantor spouse may split gifts to take advantage of annual gift tax exemptions and the lifetime gift tax exemption.



❶ Spouse A makes annual contributions to the SLAT to pay premiums on survivorship policy.

❷ During the life of both spouses the trust is given authority to distribute money to Spouse B and the children / heirs for their "health, education, maintenance and support".

❸ Upon the death of the surviving Spouse, death proceeds are received by the trust and distributed to the children / heirs based upon the terms of the trust.

Neither insured should act as trustee in order to avoid subjecting the death proceeds to estate taxes. Carefully planned and properly drafted and administered, the SLAT can accomplish a variety of goals:

- Lifetime Distributions: If necessary, the trustee can make distributions to the wife and/or children while both husband and wife are alive, for their health, education, maintenance, and support. The trustee need not wait until the death of the survivor to make distributions from the trust.

- Access to the Policy's Cash Value: The trustee can access the policy's cash value to provide income to the spouse of the grantor.

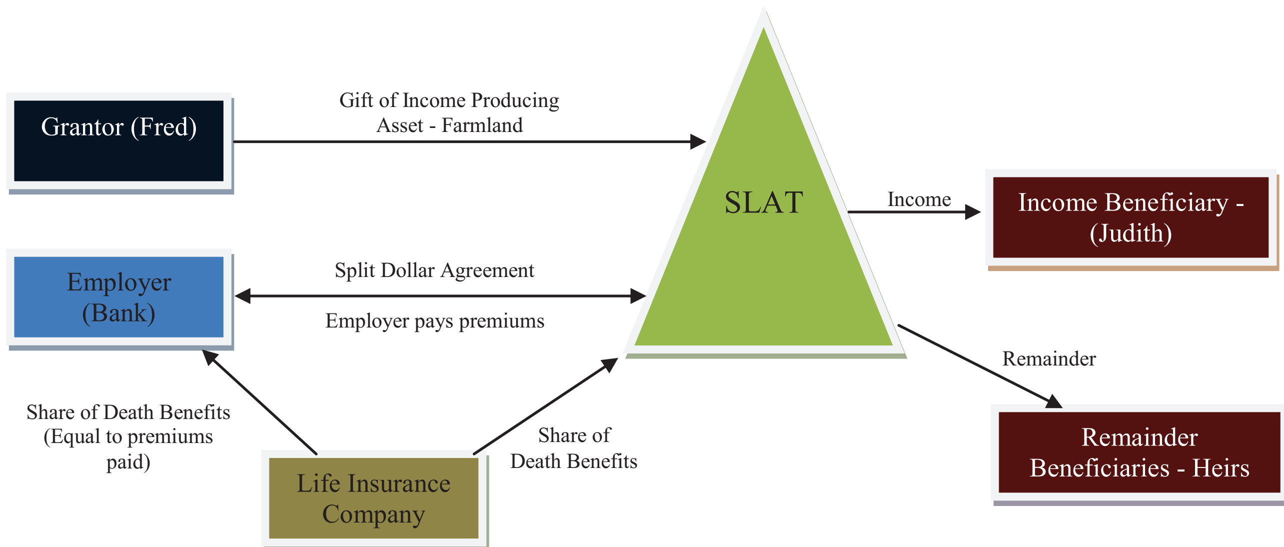
- Death Benefits Available to Children: Upon the death of the survivor of husband and wife, the trust will terminate and the remaining principal will pass to the children. This will provide liquidity to pay estate taxes and administration expenses.

Window of Opportunity – Gift Tax Exemption

The gift tax provisions of the 2010 Tax Relief Act have created a window of opportunity for high-net-worth families. Individuals may gift $5 million worth of assets free of federal gift taxes. A married couple may gift $10 million free of federal gift taxes. This increase in the gift tax exemption is scheduled to revert back to the previous exemption amount ($1 million) on January 1st, 2013. This creates an opportunity to transfer substantial wealth to a SLAT which will reduce exposure to transfer taxes while retaining access to income.

Combining a SLAT with Split Dollar

There are a number of ways to fund the life insurance policy owned by the SLAT. If your goal is to utilize cash flow from an employer, it may be appropriate to explore a split dollar arrangement.



Collateral Assignment Split Dollar

- Employer pays the premiums on a joint survivor life insurance policy owned by the Otten SLAT.
- The employer has the right to recover (from the death benefits) an amount equal to the total premiums paid, the SLAT receives the remaining death benefit above the total premiums paid.
- The employee recognizes imputed taxable income based upon the total premiums paid and current interest rates (blended annual rate provided by the IRS). The imputed income amount is also deemed a gift from the employee to the SLAT.
- Exit strategy – the SLAT may pay back the employer prior to receiving death benefits by transferring trust property to the employer equal to the total premium paid. This would terminate the split dollar agreement and all death benefits would be paid to the SLAT and distributed to the remainder beneficiaries (heirs) based on the terms of the trust.

This presentation is not intended to be accounting, legal, or tax advice. Clients should consult their legal, accounting and tax advisors about their particular circumstances before implementing any recommendations.