Current SLAT Planning Ideas to Better Serve Clients Secure Exemption and More

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Why SLATs are and will Remain An Estate Planning Tool of Choice

Many Done in 2020-2022, and more to Come Before 2026

Why SLATs are and will be the Hot Ticket

- Many wealthy clients sought to secure estate tax exemption in 2020-2021 (and even into 2022) because of the numerous harsh Democrat estate tax proposals.
- While it seems doubtful any of those will be enacted, but President Biden's Greenbook is a strategic restatement of many of those provisions. Further, Janet Yellin announced that Treasury will use its Regulatory authority to impose restrictions on grantor trusts. Some clients might pursue planning because of these risks (but perhaps not many).
- In 2026 the gift, estate and GST exemption will be cut in half under current law (no change required in Washington). As a result, clients who have not used up as much exemption as they can, will try to use exemption to secure it before it is cut.
- For married couples, the most common planning technique used in 2020-2021 was SLATs. As the 2026 elimination of the bonus exemption approaches, SLATs will again be a tool of choice for what may be another planning tidal wave.

Protection: Why SLATs Should NOT be the Only Ticket

- Recent estate planning malpractice cases suggest that practitioners should offer options and let the client select. That may provide some protection from some of the claims made. So, even if you believe one or two SLATs is the right technique for a particular client, offer (and document that you have) options. (Another key step learned is to put risks and tax consequences of the plan in writing to the client.)
- As explained below, offering SPATs, DAPTS and Hybrid DAPTs may be preferable then more “plain vanilla” SLATs. Considering variations of the traditional SLAT is important.
- If leveraged real estate is involved might offering a preferred partnership freeze plan be beneficial?
- Have you discussed non-grantor trusts for income tax savings (whether structured as a SLANT or otherwise).
- **Protection -- Offer options**!
- The fact that SLATs are so commonly used doesn’t mean that they are without risk to the client, or that they are without risks to the practitioner. Warn clients of risks in writing.

Why SLATs – 4 Topics Will Be Discussed

- SLATs are the tool of choice for married couples (and many single people who do SLATs with Siblings or others) because if each spouse contributes assets to a SLAT naming the other spouse as beneficiary the couple supposedly can:
  - **1.** Remove assets from their taxable estate.
  - **2.** Secure their temporary or bonus exemption before it drops in 2026.
  - **3.** Each spouse is a beneficiary of the other spouse’s trust so that the couple has access to all of the assets they have transferred.
  - **4.** The assets in each trust should be protected from claimants and creditors.
- That is the simplistic SLAT pitch, but that is not the full story, nor fully correct. The reality is that there are a many details involved to structuring the plan, drafting the trust, options to “typical” SLATs, funding the SLATs, administration of the SLATs, and more. That “more” is what this PowerPoint will help address. These refinements and administrative steps can enhance the benefits practitioners can offer, lessen risks to both client and practitioner and create more work for practitioners.

The More Realistic Picture of SLATs

- 1. **Remove assets from the clients' taxable estate.**
  - Yes. While many commentators talk about the **reciprocal trust doctrine issue**, that is sometimes the only issue discussed. And that is far from the only issue. As we learned from the Smaldino case, if the clients don't **administer their SLATs properly**, the plan won't work. Improper administration will undermine a SLAT more often than a reciprocal trust doctrine attack (although that should not be ignored).
  - Is there an **implied agreement** for distributions? How can you negate that challenge?
- 2. **Secure their temporary or bonus exemption** before it drops in 2026.
  - Some SLAT plans are simply done wrong. Too often the idea of the "non-reciprocal SLAT" is just used because that is the estate planning technique de jour with too little thought given to the use of the plan. In many cases couples each give $2-$5M to their SLATs so they will safeguard none of their bonus exemptions.
  - For clients that have used much of their exemptions revisit those plans before 2026 to use up the inflation boosts to those exemptions.

The More Realistic Picture of SLATs

- 3. Each spouse is a beneficiary of the other spouse's trust so that the couple has **access** to all the assets they have transferred.
  - This is a MAJOR (caps intended) issue for many plans and is often not handled adequately. Many of the issues can be addressed even after the fact, although doing so in advance of the plan is obviously preferable. These will be explored in greater depth. The key to addressing these issues is a collaborative multi-disciplinary team.
  - There are also other drafting options to consider that are not always used. Some of these might be added later, but these drafting considerations are especially important for the upcoming wave of pre-2026 planning.
  - There are also more robust options that can improve a SLAT plan.

The More Realistic Picture of SLATs

- 4. The assets in each trust should be **protected from claimants and creditors**.
  - The reciprocal trust doctrine can be used by creditors to pierce the SLAT trust structure. It is not only a tax doctrine. So, addressing the reciprocal trust doctrine is vital.
  - There are a host of proactive steps that can be taken before SLATs are funded that should be considered. Some of these might still be worth considering after the fact.
  - Drafting and planning techniques can help protect SLAT assets better than what is done in many SLAT plans. Example – don’t mandate income be distributed as that can be reached by creditors.
  - Proper administration is critical to achieving any meaningful measure of asset protection. Poorly administered irrevocable trusts are easier to pierce than properly administered trusts.

#1 Using SLATs To Remove Assets from Client's Estate

Reciprocal Trust Doctrine; Refuting Implied Agreements; Proper Administration; and More

To Be Respected SLATs Should Be Economically Viable

- To have a SLAT succeed in the goal of removing assts from the client's estate the SLAT plan must be formulated reasonably and administered properly. It is not enough just to draft a technically sufficient trust document.
- The economics of the SLATs must make sense to deflect a challenge by the IRS that there was an implied agreement with the trustee (especially a family trustee, so use an institutional trustee) to make distributions. Similarly, if the economics are not reasonable a creditor may be more apt to (or more successful at) challenging the transaction as constituting a fraudulent conveyance.
- The solution may include financial forecasts, appropriate insurance coverage (see comments later), etc.
- A critical issue is what assumptions to use in the forecasts to support the reasonableness of asset transfers? If you use excessively conservative assumptions (e.g., high inflation on costs, lower investment returns, higher budget numbers) your zeal to be conservative may unreasonably depress the value of assets that some clients may be able to transfer to their SLAT plan.

To Be Respected SLATs Should Be Economically Viable

- It should not be necessary to use the same assumptions on funding a SLAT that would be used to evaluate whether the client is on target to meet retirement or other goals.
- **Protection**: Caution to Add to Client Memo Accompanying SLAT Drafts: “Forecasts should be used to support and determine the values given to each trust. You should address this with your CPA and/or wealth adviser. Assets should not be transferred to the trusts that will likely be needed to support your lifestyle Assets should not be transferred to the trusts that will likely be needed to support your lifestyle. Your CPA or wealth adviser should assist with this, we cannot.”

How To Structure and Draft a SLAT Plan to Succeed

- To accomplish the goal of removing assets from the client's estate the SLAT plan must be done properly and the documentation must be sufficient.
- Each spouse creates a trust for the other spouse, avoiding the state law creditor and tax Reciprocal Trust Doctrines.
- This occurs by making the trusts sufficiently different so the doctrines will not apply.
- The trusts can be created at different times, with different assets and trustees, and with very different terms (checklist follows).

Watch Inter-Spousal Gifts Before SLAT Funding

- If the clients have a joint account which is to be divided do so well in advance of the funding the SLATs.
- Consider a gift letter between spouses. Example, if a joint account is used have one spouse relinquish interests in the assets given/taken by the other spouse.
- Reporting the transfers between spouses as on a gift tax return.
- Let time pass after spouse 1 gifts spouse 2 assets before spouse 2 funds a SLAT. The more time the better. Also, if there can be independent economic events while spouse 2 holds the assets (asset allocation changes and new IPS; new operating agreement with different terms and implications for entity interests), etc. Watch the issues that arose in the Smaldino case.
- Address a transmutation if necessary to break community property status for any assets so affected.
- All of this should consider the step-transaction issues as well as reciprocal trust doctrine issues.

Drafting a SLAT

- Draft the two trusts with several provisions in them that are different as between the two rusts to endeavor to deflect a reciprocal trust doctrine challenge This doctrine can result in the IRS or a creditor “uncrossing” two spousal trusts if the provisions and planning are too similar.
- Programs have templates that incorporate significant differences between the various trusts.
- Draft both SLATs at the same time to build in differences between the trusts (but others draft them at separate times to ensure a difference in time but does that matter?). But ideally have them executed at materially different dates.

Protect the Draftsperson

- **Protection**: Consider including several caveats in written communications to the client.
- "What constitutes sufficient differences to deflect a reciprocal trust challenge is not clear. Therefore, there can be no assurance that the differences in the trust instruments and plan will suffice for this purpose"
- "You should be aware that the efforts made to differentiate irrevocable trusts to reduce the risk of the application of the reciprocal trust doctrine in several instances have substantive economic and legal implications. These provisions reduce the access to a particular trust to less than it might otherwise be. These limitations, e.g., the use of a health, education, maintenance and support ("HEMS") distribution standard may also limit the ability to decant a trust in the future. There may be other ramifications as well. If you wish to review these in more detail, you should do so. If you wish further input from us, please advise."

Considerations About Estate Tax Planning

- A goal of the SLAT plan is to remove assets from the client's estate. But consider other tax planning matters as well.
- Historically, estate tax minimization has been a cornerstone of planning and it should remain important, even considering substantial uncertainty, or even in the event of estate tax repeal (and states likely will not repeal theirs). SLATs can be drafted with considerable flexibility to address many aspects of this uncertainty.
- State income tax systems vary significantly from no tax states to states that tax at very high rates, like NY and CA, among others. During the client's lifetime. non-grantor SLATs may be used to save state income taxes.
- After death of both spouses, SLATs can provide flexibility to allocate income among a class of beneficiaries to those in lower **state**, or no tax states.
- Federal income tax rates have historically been progressive, although the difference between the highest and lowest rates has fluctuated widely over time and may continue to do so. SLATs provide a mechanism to allocate income among a class of beneficiaries to those in lower **federal** (and state) brackets.

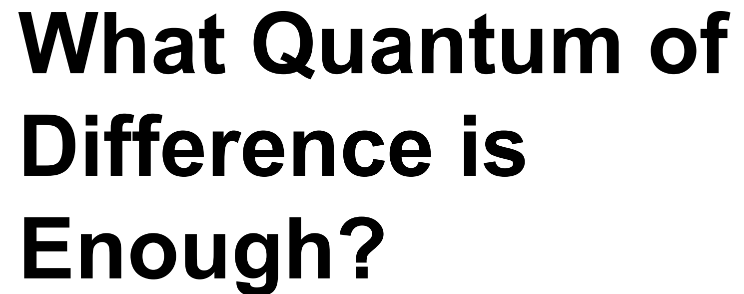
Consider Impact of SLAT Removing Assets from Estate on Tax Basis (No Step-Up)

- **Protection:** Caution clients about possible loss of basis step up if the SLAT plan succeeds in moving assets outside the client's estate
- Basis maximization can provide valuable income tax planning opportunities, and SLATs can be tailored to facilitate this through:
  - Distribution of assets to beneficiaries, e.g. a spouse/beneficiary of advanced age.
  - Use of powers of appointment, e.g. give an elderly parent a general power of appointment to cause SLAT assets to be included in their estate and to achieve a basis step up during the grantor's lifetime or to trigger the Delaware Tax Trap per Section 2041(a)(3).
- Swap powers can provide more flexibility to maximize income tax basis or accomplish several other important planning goals. The traditional application of a swap power is for an elderly or infirm grantor to swap cash into the SLAT in exchange for highly appreciated SLAT assets.

SLAT – Life Insurance/ILIT

- For clients wishing to remove SLAT assets from their estate the same trust and same assets, with a modicum of planning, can serve double duty as an ILIT. Just watch out for the investment trustee/insurance trustee functions.
- For clients unlikely to face an estate tax, the simplification of a multi-purpose SLAT/ILIT may be a welcome option.
- Permanent life insurance policies used to fund the SLATs will represent an alternative asset class (in most to be invested in a conservative manner), and the accumulated cash values can be accessed, tax-free, for retirement or other purposes, via trust distributions to the spouse-beneficiary. In the event of a spouse beneficiary's premature death, the surviving spouse can be protected by having the other spouse’s SLAT(n which the survivor is a beneficiary) hold life insurance. This will be explored further below.
- Life insurance cash values will grow tax-free, and the eventual death benefit won't be subject to either income tax or transfer taxes.
- Consider the benefits of combining old-style ILITs into a SLAT. This can be done by a late allocation of GST exemption to the old ILIT then decanting or selling insurance to the SLAT and then liquidating the ILIT.

Make the SLATs Non-Reciprocal



Might Life Insurance Help Deflect a Reciprocal Trust Doctrine Challenge

- Have one trust by life insurance but not the other, or have each trust buy different types of coverage. If one trust buys $5 million whole life and the other trust buys $10 million 20-year term, aren't the economics of each trust substantively different?
- Does the insurance coverage alone help differentiate the two trusts? If the SLATs were set up last year might a 2022 insurance purchase be considered part of the same plan?
- Different view among commentators but different assets and values in each SLAT according to some result in a different economic position for each spouse after the SLATs are created and some believe that may break the reciprocal trust doctrine.

Might Different Asset Allocations Deflect a Reciprocal Trust Challenge

- Before transferring assets to a SLAT, if it is all marketable securities, consider differentiating the assets each spouse transfers.
- Create an investment policy statement ("IPS") for each SLAT that differs.
- If one spouse transfers bonds and alternative investments, and the other transfers stocks, does that differentiate the trusts? No, but it does, arguably, leave the spouses in different economic positions then they were before the funding of the SLATs. That should be an important factor.
- If this was not done and each spouse transferred a diversified portfolio to their respective SLAT might changing asset allocations soon after help?

Differentiate SLATs

- Create each SLAT in a different state. This infuses into each SLAT differences under each state's laws. This is simple with document generation software you merely select the state for each. This may be valuable for asset protection purposes as well, especially if each state is a DAPT jurisdiction.
- **Draft Differences into Each SLAT**:
- In one trust:
  - the beneficiary spouse can be entitled to distributions each year,
  - have a lifetime broad special power of appointment,
  - can change trustees (within Rev. Rul. 95-58 safe harbor),
  - withdraw under HEMS.
- In the other trust:
  - The beneficiary spouse would have no entitlement to distributions (perhaps is not even a current beneficiary), or if above trust is HEMS this could be broader
  - no power to change trustees,
  - and no power of appointment,
  - but could become eligible to receive a distributions only upon exercise by a trusted child of a power to add beneficiaries.

Checklist of Differences to Integrate into SLATs - 1

- The following checklist is from Steiner and Shenkman, "Beware of the Reciprocal Trust Doctrine," Trusts & Estates magazine:
- Draft the trusts pursuant to different plans. A separate memorandum or portions of a memorandum dealing with each trust separately may support this. Have the different plans been followed?
- Don't put a husband and wife in the same economic position following the establishment of the two trusts. Have the trusts been operated in this manner?
- Use different distribution standards in each trust. For example, one trust could limit distributions to an ascertainable standard, while the other trust could be fully discretionary. However, limiting distributions to an ascertainable standard reduces flexibility may prevent decanting and may expose the trust assets to a beneficiary's creditors. Are the trustees respecting the different distribution standards?

Checklist of Differences to Integrate into SLATs - 2

- Use different trustees or co-trustees. Has this been respected or have they changed the trustees to now be identical?
- Give one spouse a noncumulative “5 and 5” power, but not the other. If done has this been respected in trust operations? Should a spouse holding a power partially exercise it to demonstrate its reality?
- As in *Levy* and PLR 9643013, give one spouse a special power of appointment, but not the other. However, the absence of a power of appointment reduces the flexibility of the trust. This might be viewed as particularly significant in light of the continued estate tax uncertainty. Do the client’s wills, for example, reflect the appropriate exercise of powers only where they exist?

Checklist of Differences to Integrate into SLATs - 3

- Give one spouse the broadest possible special power of appointment and the other spouse a special power of appointment exercisable only in favor of a narrower class of permissible appointees, such as issue, or issue and their spouses. Do the client's wills, for example, reflect the appropriate exercise of powers only where they exist?
- Give one spouse a power of appointment exercisable both during lifetime and by will and the other spouse a power of appointment exercisable only by will.
- In the case of insurance trusts, include a marital deduction savings clause in one trust, but not the other..

Checklist of Differences to Integrate into SLATs - 4

- Create different vesting provisions for each trust. For example, the two trusts could mandate distributions at different ages, or in a state that has repealed or allows a transferor to elect out of the rule against perpetuities, one trust could be a perpetual dynasty trust. However, mandating distributions severely reduces the flexibility of the trust, throws the trust assets into the beneficiary's estate for estate tax purposes and exposes the assets to the beneficiary's creditors and spouses. Whatever terms are in the trust confirm that they are being respected when distributions are made.
- Instead of mandating distributions, give the beneficiaries control or a different degree of control, at different ages. For example, the ages at which each child can become a trustee, have the right to remove and replace his co-trustee, and have a special power of appointment could be different in each trust.
- Vary the beneficiaries. For example, one spouse could create a trust for the spouse and issue, and the other spouse could create a trust just for the issue. Note that if, for example, the husband creates a trust for his wife and their first child, and the wife creates a trust for her husband and their second child, the gifts could still be viewed as reciprocal. Is this being respected?

Checklist of Differences to Integrate into SLATs - 5

- Contribute different assets to each trust, either as to the nature or the value of the assets. Contributing different assets may not negate the application of the reciprocal trust doctrine, since the assets in a trust may be susceptible to change over time. However, if one trust is funded with non-liquid assets, or assets subject to contractual restrictions on sale (e.g., operating agreement restrictions on transfer of interests in an LLC) that may be viewed as a more meaningful difference in assets that may not be susceptible to ready modification. Have assets changed? Has this been monitored to maintain different plans?

For SLAT assets to Be Outside Settlor’s Estate Requires Proper Administration

Administer: Defined Value Clauses – 1A Wandry

- Defined value mechanisms are used in funding of many SLATs but too often they are not administered properly. That could undermine the plan and estate exclusion.
- Determine what type of defined value mechanism was used in each transaction and be certain that 709s and 1040s and 1041s all returns properly reflect the existence of such a mechanism.
- Defined value clauses - Wandry.
  - Defined value clauses endeavor to deflect a gift tax valuation challenge by defining the gift in a manner that mitigates the impact of an IRS valuation challenge.
  - Wandry clauses are the most common approach as they are simple and inexpensive to implement.
  - A more complex approach may be safer.
  - I gift (sell) $_____ worth of LLC interests. Those interests have been estimated based on an appraisal to be ______% of the LLC. The actual percentage interest given/sold shall be determined by the value finally determined for federal gift tax purposes.

Administer: Defined Value Clauses – 1B Wandry

- Tax Court in *Wandry* T.C. Memo 2012-88 upheld the defined value mechanism based on the specific wording of the clause in the assignment documents
- IRS issued a statement refusing to acquiesce to the Tax Court's conclusion, signaling strong disagreement of *Wandry* (Action on Decision 2012-004) – but not enough to appeal the case. **Protection**: Recommend clients consider options (see below) as Wandry is not the guarantee some clients might believe.
- *Wandry* approach results in only the intended dollar amount of the assets being transferred with any excess above that amount remaining in the transferor's estate
- Any assets remaining in the transferor's estate are subject to future estate tax. That may also raise a Powell issue.
- Confirm that bank trust records, client and trust financial statements, all reflect the uncertainty of ownership interests if applicable under the precise mechanism used.

Administer: Defined Value Clauses – 2 Christenson/Petter Waterfall

- Defined value clauses can be structured in a different manner than Wandry. Some commentators believe these approaches are safer.
  - The client parts with 100% of the desired interests in the transfer. This contracts with Wandry were some of the interests may not be transferred in the transaction.
  - I hereby transfer all of my rights and interests in XYZ, LLC pursuant to this transaction. I gift (sell) $_____ worth of LLC interests to the Smith Family Trust. Those interests have been estimated based on an appraisal to be ______% of the LLC. The actual percentage interest given/sold shall be determined by the value finally determined for federal gift tax purposes. Any interests in XYZ, LLC not transferred to the Smith Family Trust above shall pass to the Smith Family Donor Advised Fund, up to a maximum amount of $2 million dollars. Any excess value over the amounts transferred to the Smith Family Trust and the Smith Family Donor Advised Fund are hereby transferred to [Smith Family GRAT] [Smith Family Incomplete Gift Trust] [John Smith Marital Trust], etc.
  - The benefit of a waterfall clause is that the client has parted with all interests no matter.

Administer: Defined Value Clauses – 3 Nelson Case

- Nelson case.
  - Nelson v. Commissioner, T.C. Memo 2020-81: the taxpayer's valuation adjustment mechanism failed because it did not use the requisite language of referring to: gift tax value as finally determined and instead had a reference to an appraised value
  - The value used in a valuation adjustment mechanism must be based on the gift tax value as finally determined for federal gift tax purposes. In Nelson a baule was based on appraisal. Use the language used in the case law, don't vary from that.
  - CPAs should review the language and if it is wrong advise counsel to correct the documentation if feasible. Also, consider what should be disclosed on a gift tax return. If the language in the Wandry clause is not sufficient and a revision is made, should both documents be attached as exhibits for "adequate disclosure?

Administer: Defined Value Clauses – 4 Double Wandrys

- The problem with a Wandry clause is that some portion of the equity interests the client is shifting out of their estate may remain in the estate if there is a valuation adjustment. That is because only a fixed dollar value is sold.
- Having a residual interest in the estate could be particularly problematic if discounts are repealed, transfers to grantor trust included in the grantor's estate, and other changes enacted.
- One solution is to use the Petter/Christenson waterfall as discussed above.
- Another approach is to use what might be referred to as a "double Wandry." The "first" part of the Wandry is the traditional Wandry transfer. The "second" or "double" portion of the Wandry is to sign a secondary sale agreement that sells, effective as of the date of the initial transfer, any equity remaining in the client's estate is sold as of the same date as the original transfer, at the gift tax value as finally determined.
- This approach removes 100% of the desired interests from the estate and should do so without gift tax implications.

Administer: Defined Value Clauses – 5
Double King

- A King price adjustment mechanism increases the face amount of the note to equal any gift tax value as finally determined. So instead of changing the percentage of shares transferred, or allocating using a waterfall, the note amount on a sale is increased to reflect the proper value.
- This is based on a 10th Circuit case. Some commentators suggest that a King clause because it is only a 10th Circuit case is not as secure as a Wandry which is a Tax Court case. Other commentators suggest that since King adjustments are commonly used in the business world that there is significant merit to the technique. On the latter point, some commentators suggest that King adjustment mechanisms should be used in transactions that have a business context.
- In client's haste to complete planning before changes in the law, if a King note adjustment mechanism is used, does the transfer have to wait to receive the valuation? Yes.
- But if the client is anxious to close the transfer perhaps an estimate of value can be used. Then, when the appraisal is received the King note will be adjusted. The "second" or "double" adjustment will occur for gift tax value as finally determined in which case the note will be adjusted a second time.

Administer: Swap/Substitution Powers

- Swap or substitution powers are common. So is misapplication of such provisions. That may undermine the estate and asset protection goals of the SLAT.
- In a grantor trust periodically review the swap power and evaluate options to using it.
- This power can be used to create grantor trust status (income of the trust is taxed to the settlor). Section 675(4)(C). But it also is an incredible tool to build in flexibility. Your client can transfer family business interests to an irrevocable trust, locking in valuation discounts available under current law. But if your client later wants to return those assets to your name, the settlor can swap in an equivalent amount of cash and get the business back.
- This could be useful to obtain a basis step up on death. It could enable the client to change his or her dispositive scheme and transfer the business to another heir.

Administer: Swap Powers Properly

- The client/settlor must have property available to effectuate a swap. In many cases cash might be the easiest or preferable asset, but few settlors have addressed this. Practitioners can assist these clients in creating lines of credit to be “at the ready.”
- Analyze trusts for highly appreciated assets part of the annual review process.
- Assure that if a swap is done that the terms of the trust are followed so that the transaction is in compliance with its requirements.

#2 Using SLATs to Secure Exemption

Perhaps Only One Spouse Should Fund a SLAT

SLATs To Use Exemption

- One of the 4 key goals of SLAT planning is to use and secure temporary or bonus exemption before it is reduced by half in 2026.
- Exemption can be secured by gifting assets to completed gift irrevocable trusts.
- Be certain that there are no LPOAs or other retained powers the settlors/donors have that could taint the trust as an incomplete gift trust. State in the instrument that the intent is to be a completed gift so that if an error occurs a court will have no doubt as to what the settlor's intent was if a construction action is bought.
- File a gift tax return to toll the statute of limitations. Carefully endeavor to meet the adequate disclosure rules.
- Consider reporting inter-spousal gifts even if not required to endeavor to toll the statute of limitations on a step-transaction challenge.
- Affirmatively allocate sufficient GST exemption to assure a zero-inclusion ratio since the GST exemption will be cut by half in 2026 as well as the gift exemption.

Should Both or Only One Spouse Fund a SLAT? - 1

- **Example - 1**: Husband and wife have a combined estate of $16 million and are willing to make $8 million in total gift transfers in 2020 to safeguard a portion of their temporary exemptions. If each of husband and wife transfer $4 million to a non-reciprocal spousal lifetime access trust ("SLAT") they will have safeguarded $8 million of exemption (and any future growth on those assets) in case the law changes. In 2026 when the exemption declines by half, to $5 million each (ignoring inflation adjustments) each spouse will be left with $1 million of exemption. So, if you add the $4 million each spouse used in the 2020 planning and the $1 million each has left in 2026, the couple will have preserved $10 million of exemption. Good, but they can do better. If in 2020 with a Dem sweep and the estate tax exemption is reduced to $3.5 million, the couple will have no further exemption left, but they'll be hugging their estate planning for having helped them safeguard $8 million before those changes.
- But then the total exemption safeguarded is only $8 million. Is that optimal? Maybe. But perhaps not. Consider having one spouse, not both, use current exemption thereby preserving more exemption for future planning.

Should Both or Only One Spouse Fund a SLAT? - 2

- **Example - 2**: Assume the same facts as in the above example. Husband and wife have a combined estate of $16 million and are willing to make $8 million in transfers to irrevocable trusts to secure a portion of their temporary exemptions. But instead of setting up two non-reciprocal SLATs as in the above example, the wife gifts $8 million to a DAPT. Her husband and all descendants are beneficiaries of the trust. So with husband as a beneficiary, so long as he is alive and they remain married she has indirect access to the $8 million through husband. You could incorporate a mechanism into the trust to add wife in as a beneficiary in the future (see hybrid DAPT below) just in case her husband dies prematurely or divorces. If the exemption drops to $5 million in 2026 as the law currently provides. Wife used $8 million of her exemption so she'll have none left. But, since husband did not use any of his exemption in the plan, he will still have $5 million of exemption left in 2026. So his $5 million of exemption and the $8 million of exemption the wife used in 2020 means the couple has preserved $13 million of exemption, $3 million more than had they used the non-reciprocal SLAT approach in the prior example.

#3 Maximizing Access to SLATs

Access is Key for Most Clients

- Do clients have sufficient access to assets in their irrevocable trusts to be comfortable? Have they considered this factoring in market volatility, recission risks, and other "what ifs"? Estate planning attorneys may not have quantified (or even addressed) these issues, but financial and insurance consultants and CPAs can and should do so ideally before the funding, but if not as soon as possible thereafter. This should be done even after the fact, apart from tax reasons, to identify potential financial gaps in the plan that should be addressed proactively before those issues become acute.
- Evaluate SLATs/ILITs to determine if adequate access was provided. If not, consider trust protector action, decanting, non-judicial modification, or other steps to enhance access.

With Only 1 SLAT To Secure Exemption Impact of Mortality Risk May Be Greater

- If only one spouse creates a SLAT, then the premature death of that spouse creates an accentuated mortality risk for the donor/settlor spouse. Life insurance can mitigate that risk. Thus, when only one robust SLAT is warranted, it may be advisable for the other spouse to create a simple ILIT to own life insurance to protect the donor/settlor spouse from mortality risk.

Review Broad Insurance Plan to Backstop 2020-2021 Planning Done in Haste and All SLATs

- Many plans implemented in 2020-2021 were done in haste and without the deliberate planning that would have been ideal had time pressure not existed.
- Disability coverage – review coverage for those with meaningful work expectancy left that transferred significant resources to irrevocable trusts.
- Long term care coverage – review coverage for those who transferred significant wealth to trusts and might be more comfortable knowing they have a plan in place to address care costs.
- Life insurance – to address gaps in SLAT planning (e.g., premature death), and to build a hedge against market volatility.
- **Protection**: Consider that having an insurance consultant evaluate the financial risks of the plan and how insurance may help will help the client understand the plan and see options to address financial risks. That may serve to also protect the practitioner.

Beneficiaries

- Encourage clients to consider including a broad class of beneficiaries in SLATs, not just the spouse.
- More beneficiaries means more flexibility for future income tax planning and a more robust SLAT. If the NIIT is not repealed each child's AGI is viewed separately from the parent's AGI for purposes of testing whether the Medicare tax on passive income applies. IRC Sec. 1411. If the child's AGI is under $200,000 the child will not be subject to the Medicare tax.
- Many attorneys still draft trusts including only the spouse or only the spouse and children as current beneficiaries instead of including the spouse and all descendants.
- Should "floating spouse" clauses be used for flexibility? While this may be worrisome to the existing spouse (**if we divorce, I lose access but remain taxable on the grantor trust income**) it is an important option to help the donor/settlor spouse have an additional means to access trust assets if the current spouse dies and the donor/settlor spouse loses the indirect access to the SLAT. Consider a floating spouse clause only in event of death but not in the event of divorce of the current spouse.
- Definition of "Spouse." For purposes of this Agreement, any reference to my Spouse shall mean my current spouse Jane Doe, if she dies before I die, or she and I become divorced, or our marriage is annulled, the person to whom I am married at any given time.

Access: Include Trust Protectors

- Include trust protectors in almost all SLATs. The flexibility a protector might add may be useful in fine-tuning provisions useful to providing access. For example, if the current trustee is not distributing liberally enough to the spouse/beneficiary the protector can replace that trustee.
- Giving a protector the power to change the governing law and situs, and so forth, infuses flexibility to respond to future access needs. For example, the trust might be moved to a jurisdiction having more liberal decanting or other provisions.
- Caution – naming a protector might subject a trust, once no longer a grantor trust, to state tax nexus based on the residence of the protector. One approach suggested to mitigate this risk is to “house” all ancillary functions (trust protector, investment adviser, et.) inside an LLC formed in the trust friendly jurisdiction where the trust is based.

Access: Trust Protector Powers

- The power to remove Trustees.
- The power to appoint an individual, corporation or other entity with fiduciary powers to replace any removed Trustee, or to add a new additional co-Trustee.
- The power to appoint an individual, corporation or other entity who is not related or subordinate to the Grantor or the Beneficiaries with fiduciary powers to exercise powers granted in this Trust. Rev. Rul. 95-58 safe harbor.
- The power to change situs and governing law of the trust, correct scrivener's errors, modify administrative provisions that have no effect on the beneficial interests in the trust.
- The power to modify or amend the supplemental needs trust provisions herein to conform with any changes in applicable law.
- The power to restrict or eliminate the right of the Trustee to apply the income of this trust to pay life insurance premiums on the life of the Grantor and/or the Grantor's spouse.

Access: Trust Protector Powers

- The power to change the name of the Trust and governing law.
- The power to demand an accounting and the right in the Trust Protector's sole discretion to submit same to a court or not.
- The power to direct the Trustee as to which beneficiaries, fiduciaries or other persons holding powers hereunder (whether in a fiduciary capacity) (individually or collectively "Notice Persons") shall or shall not be entitled to receive information concerning this Trust, including but not limited to periodic investment statements and other notifications, to the extent not inconsistent with applicable state law. While Grantor is alive and not disabled no such notifications shall be given to any Notice Persons hereunder other than the Grantor and the Trust Protector unless the Trust Protector authorizes same, or applicable state law requires otherwise. No trustee shall be liable for notifications following Grantor's disability until such Trustee has actual knowledge, or receives written notice of same.

Access: Permit Adding/Including Charitable Beneficiaries

- Being able to benefit charities may provide an indirect benefit to the settlor/donor but do not let the trust pay/discharge any charitable pledges of settlor/donor.
- Before swap powers became de-rigueur trusts to create grantor trust status sometimes included a right for a person, acting in a non-fiduciary capacity, to add a charitable beneficiary. This right, during the grantor's lifetime, characterizes the trust as a grantor trust.
- With all the uncertainty over income and estate tax law changes, consider adding a broader charitable designator provision.
  - If the income tax rules for charitable contribution deductions become more restrictive perhaps it will be advantageous from an income tax perspective to make the gifts out of a trust instead of by the individual.

Access: Permit Adding/Including Charitable Beneficiaries

- Don’t have the power end on the grantor’s death, permit it to continue in perpetuity since the purpose is not merely to trigger grantor trust status, but to add flexibility to planning. If the estate plan is successful significant wealth will be shifted out of your client’s estate to long term irrevocable trusts. What resources will future generations direct to charity if their inherited wealth is in trust with no charitable beneficiaries?
- Consider IRC Sec. 642(c) – can a trust get a FMV deduction for gifts in kind? IRC Sec. 642(c) is more limited than IRC Sec. 170.

Access: Provision to Make Loans

- Access is vital. If you cannot be a beneficiary of your SLAT being able to borrow funds from the SLAT without security may provide a valuable means of access if your spouse dies prematurely.
- It had been common to include a power to a person acting in a non-fiduciary capacity to make loans to the settlor of the trust. Adequate interest should be charged but adequate security is not necessary. This too should have characterized the trust as a grantor trust.
- While grantor trust status might be achieved with a swap power, perhaps a loan provision should still be included, but now more for providing a means for the settlor to access trust principal than for grantor trust characterization. If the estate tax is repealed your client might be happier with the planning knowing that there is a means to provide the client access to trust funds, even if that is as a loan.
- Should you always use a loan provision to back stop issues some commentators perceive with swap powers not assuredly granting/creating grantor trust status?

Sample Loan Provision

I appoint John Smith as the Loan Director. During my lifetime, the Loan Director shall have the power, exercisable at any time and from time to time in a non-fiduciary capacity (within the meaning of Code Sec. 675) without the approval or consent of any person in a fiduciary capacity within the meaning of that section, to compel the Trustee to loan some or all of the trust property to me without adequate security within the meaning of Code Sec. 675(2) although with adequate interest within the meaning of that section. I direct that this power is not assignable. In the event that Mary Simpson dies before I die, the successor Loan Director shall be such individual (other than me, any person acting as a Trustee under this instrument or anyone who is an adverse party within the meaning of Code Sec. 672) whom Mary Simpson shall have designated by instrument in writing. Any person other than Mary Simpson acting as a Loan Director hereunder shall also have the power to name a successor Loan Director by an instrument in writing. In the event that no one else is acting as a Loan Director hereunder, the oldest individual acting as a Trustee hereunder (or if none, the corporation or other entity acting as Trustee hereunder) shall be the Loan Director but acting only in a non-fiduciary capacity.

Access: Death of First Spouse

- IN a SLAT indirect access can be obtained for the settlor/donor spouse through the beneficiary spouse, but death cuts off that access.
- A non-grantor SLAT (a spousal lifetime access non-grantor trust or "SLANT") can permit distributions to a spouse with consent of an adverse party. But it cannot include the powers to benefit the donor spouse after the death of the beneficiary spouse as those powers would taint the trust as grantor.
- Must consider risks of death of first spouse in a SLAT or SLANT. The economics of all of this may have changed from when the trust was funded. Has this been reviewed?
- In a Grantor SLAT consider whether the following have been provided:
  - Loan provisions
  - Hybrid DAPT
  - SPAT – special power of appointment trust

Access: DAPT

- Many irrevocable trusts plans for couples merely use non-reciprocal SLATs but broader access can be given to trust assets with additional techniques. Also , mixing the techniques can further differentiate the trusts for purposes of the reciprocal trust doctrine. One such option is a DAPT, another is a so-called "hybrid-DAPT." A Domestic Asset Protection Trust ("DAPT") is a trust in which the settlor is also named as a beneficiary. This type of trust must be created in one of the 19 Jurisdictions that permit self-settled trusts.
- With a DAPT access is at the discretion of the independent trustee (consider using an institutional trustee in the DAPT jurisdiction) so that the settlor/donor has access in the event of the death or divorce from the spouse/beneficiary. That would seem to secure the settlor/donor spouse financially. But there is another significant potential benefit. If one spouse creates a SLAT and the other a DAPT, that would seem to further differentiate the two trusts in a material manner that is safer than any two SLATs could be.

Access: DAPT

- Some practitioners are concerned over DAPTs. However, since Alaska enacted the first DAPT statute in 1998 the number of DAPT jurisdictions has expanded to 19 which is quite significant. Further, while a few cases (Mortensen, Klabacka, etc.) have held against DAPTs each of those has been a bad fact case with issues of fraudulent conveyances. For those that remain concerned, the use of a hybrid-DAPT may feel safer. In a hybrid-DAPT the settlor/donor is not listed as a beneficiary but is among the class of persons who a non-fiduciary powerholder can add as a beneficiary.
- Is such a provision included? Is the trust in a DAPT jurisdiction? If not should it be moved? Certainly before adding the settlor back as a beneficiary.
- If the trust is formed and administered in one of the 19 states that permit self-settled domestic asset protection trusts (DAPTs), the settlor can be a beneficiary of his or her own trust.
- However, if the settlor resides in a state that does not permit these trusts, some advisers view it as risky, or even not viable, to create a DAPT in a state that does.

Access: Hybrid DAPT

- There is an alternate or variation of a solution that might reduce the risk some experts perceive yet leave open the possibility of the settlor benefiting from the trust. Don't name the settlor initially as a beneficiary. Instead give someone the right to add as beneficiaries of the trust the descendants of settlor's grandparents. So, if your client/the settlor is not a beneficiary now, the trust should not face that risk. But the client has the possibility of being a beneficiary if your client needs access in the future.

Access: Hybrid DAPT Provision - 1

- Did the trust grant the person who might call the "Designator" the right/power to add descendants of Grantor's grandparents, including grantor, as a beneficiary of the trust.
- Sample Provision:

Power to Designate Additional Beneficiaries

- The Grantor appoints Jane Doe as the Designator. During the Grantor's lifetime, the Designator, shall have the power, exercisable at any time and from time to time in a non-fiduciary capacity, and without the approval or consent of any person in a fiduciary capacity, to add as additional beneficiaries hereunder any person who is a descendant of Grantor's grandparents who is not already designated herein as a…

Access: Hybrid DAPT Provision - 2

Power to Designate Additional Beneficiaries

- …Beneficiary. Further, the Designator may at any time remove any person so added by written notice to the General Trustee, so that from the date of such written notification that added descendant of Grantor's grandparents shall cease being a beneficiary hereunder. The Grantor directs that this power is not assignable. In the event that the above person is unable to serve, the successor Designator shall be such individual (other than the Grantor, any person acting as a Trustee or fiduciary under this instrument) whom the above person shall have designated by an instrument in writing. Any person other than the above person acting as a Designator hereunder shall also have the power to name such additional beneficiaries as hereinabove provided.

Access: Hybrid DAPT issues

- What if the person holding the power, the Designator, dies or becomes incapacitated, before exercising the power? Is a successor named?
- Might a court infer an implied agreement between the Designator and the settlor?
- Will a client have a person or persons they are comfortable to name?
- Consider the Ionatti case out of NY in which a person holding a hybrid-DAPT power in a fiduciary capacity was deemed to have exercised the power so that the state could reach assets for Medicaid.

Access: SPATs

- Another variation to the DAPT or hybrid-DAPT that some commentators have suggested is a Special Power of Appointment Trust or "SPAT." As with the DAPT comment above, using a SPAT does the double duty of giving more access to the settlor/donor to a trust and also differentiates that trust from a more traditional SLAT. Thus, using a combination of one SLAT, DAPT, SPAT, Hybrid DAPT for one spouse, and a different variant for the other spouse, may be preferable for avoiding the reciprocal trust doctrine then using two "traditional" SLATs.
- SPAT provisions can be integrated into the SLAT format to address risk of the settlor's spouse's premature death.
- A SPAT mechanism give someone, in a non-fiduciary capacity, a collateral power of appointment, allowing distribution of trust property to anyone in a class that includes the grantor (such as descendants of the grantor's grandparents)

Grantor SLATs: Summary of Additional Ways to Provide Grantor Access - 1

- **Loans**: Consider granting to someone the power, in a non-fiduciary capacity, to loan the grantor trust assets. Some might refer to this as a "loan director," but other titles might be used as well. A loan director can determine to loan funds to grantor of the SLAT without adequate security for the loan (but the loan director could be required to charge adequate interest to avoid tax issues). This mechanism provides the grantor another means to access trust assets should the grantor require them.
- **Charity**: You might also infuse another means of the grantor indirectly "accessing" funds in a SLAT. Give someone, in a non-fiduciary capacity, the power to add charitable beneficiaries. This person might be called a "charitable director," but other titles might be used as well. A charitable director can determine to add charitable beneficiaries to a SLAT. This provides the grantor an indirect means of "access" to the SLAT by making a charitable donation the charitable director can add the charity to the SLAT and the donation can be made out of SLAT funds not the grantor's funds. However, the SLAT cannot pay a charitable pledge of the grantor.

SLATs: Summary of Additional Ways to Provide Grantor Access - 2

- **Vacation Home**: A SLAT could own an interest in a vacation home. And if the grantor's spouse/beneficiary uses the vacation home, the grantor presumably can as part of the spouse's family. Bear in mind if that is to be done a limited liability company ("LLC") should be formed in the state where the SLAT is governed and administered. That LLC should be authorized to do business in the state where the vacation home is located. That LLC would own the vacation home property and in turn the trust could own some or all of the interests in the LLC.
- **Income Tax Reimbursement**: If the SLAT is structured to be a grantor trust (i.e., the grantor pays the income tax on trust income) consider including a discretionary income tax reimbursement clause. This permits the trustee of your SLAT, in the trustee's discretion (it cannot be mandatory) to reimburse the grantor for income tax paid on trust income. A tax reimbursement provision can add valuable flexibility and access to the grantor.

#4 Using SLATs To Protect Client's Assets

Get the Team Involved: Forecasts, Insurance, Due Diligence and More

Asset Protection With SLATs

- SLATs can provide meaningful asset protection from potential claims of creditors and other predators (that is, a beneficiary's spouse in the event of divorce and from the spouse of the spouse beneficiary who remarries). This protection applies to assets transferred to the trust if not characterized as a fraudulent conveyance. When a SLAT serves as an ILIT, policy cash values during the insured's life, as well as death benefit proceeds, could also be protected.
- Because SLATs are not self-settled trusts, they should not be subject to the risks that some commentators believe inherent in self-settled trusts created in certain domestic asset protection trust (DAPT) jurisdictions permitting such trusts, by settlors residing in jurisdictions that do not permit them.
- It is critical that only the grantor spouse contribute property to his or her DAPT and that jointly owned property not be used to fund either spouse's DAPT.
- Consider organizing the SLATs in DAPT jurisdictions (that is, those that permit asset protected self-settled trusts) to protect against such a slip-up.

Asset Protection With SLATs

- Create SLATs and transfer assets to them to use up current estate tax exemption. For larger estates, note sales and other techniques can be used to shift value into protective trust structures.
- If there is a known issue your client may not be able to transfer assets without it being viewed as hindering, delaying or defrauding the claimant (a fraudulent conveyance). The time to plan is when the client does not yet need to plan. So regardless of the status of the gift, estate or GST taxes, planning now is better than waiting until a later.
- For some physicians, or others concerned about and facing ongoing liabilities, "creeping" SLATs might be a useful approach. Create the SLAT now and make ongoing gifts to the SLAT each year so that no one gift transfer is significant. But if the other spouse is doing the same as to a SLAT he or she has created, the reciprocal trust doctrine might become more problematic.

Asset Protection: Combine SLATs with Entities

- Use family limited partnerships ("FLPs") and/or limited liability companies ("LLCs") to hold assets, e.g., any real estate property or business venture generally should be held in a separate LLC.
- Use separate entities for each operating business and real estate property. Segregate marketable securities in its own FLP or LLC.
- Entities may be manager managed to provide flexibility in management, even if held by a directed SLAT. Further, compensation for services of those serving may provide another mechanism for economic benefit to be distributed out of the SLAT structure.
- Entities are essential for a SLAT in a trust friendly jurisdiction to own real estate in a different state.
- Watch Powell issues if the client retains any entity interests.

Bolstering Asset Protection Benefits of a SLAT Plan

- A well-done SLAT plan will incorporate several steps that may help secure the tax objectives, but which will also help secure the asset protection benefits. These might include:
  - Internet searches on the client and any significant businesses the client may be involved in, to document that no significant issues exist.
  - Economic projections (Monte Calo simulations) of anticipated results to demonstrate that the transferor has adequate resources after the transfer.
  - Lien and judgement searches. Consider hiring a consulting firm (e.g., a CPA firm that does forensic work) that routinely prepares reports evaluating the status of clients.
  - Having the transferor sign an affidavit of solvency regardless of whether one is required by law (which is the case for self-settled trusts in some jurisdictions).
  - Place the trust in a "trust friendly" jurisdiction.
  - Name an institutional trustee. Consider the Court's comments in the Levine split dollar case.
  - Minimize contacts with the client's home state.

SLATs: Legal, Insurance and Financial Planning to Backstop the Most Popular Estate Planning Technique

Conclusion and Additional Information

Conclusion

- The tax law and planning environment are and likely always will be in a state of flux.
- SLATs provide a useful planning tool for many married couples to achieve a wide range of both tax and non-tax goals.
- Plan SLATs with flexibility.
- Consider enhancements like DAPTs, SPATs, loan provisions, charitable beneficiaries, and more.
- Administer trusts properly.
- **Protection**: Caution clients of issues in writing.

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