

SLATs and Life Insurance: Have Your Cake and Eat it Too

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RAYMOND JAMES

**RAYMOND
JAMES**

This gifting strategy can provide estate tax benefits without giving up access to policy cash value, if needed in the future

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Time may be running out to use the current, unprecedented \$5.12 million gift [tax](#) exemption, which is scheduled to revert to \$1 million in 2013. For those on the fence, a balanced [strategy](#) is vital.

Most gifting strategies require the taxpayer to give assets away with no strings attached. Couples with assets valued between \$20 million and as high as \$50 million typically are reluctant to give away \$5 million or \$10 million, in case they someday need the gifted assets. A spousal lifetime access trust (SLAT), coupled with the purchase by the SLAT of some life [insurance](#), may provide the best of both worlds: a completed gift, removal of trust assets from a couples' gross [estate](#) and a tax-favored leveraged death benefit, all while allowing a beneficiary spouse the flexibility of retaining tax-efficient access to the policy cash value, if needed in the future. Generation-skipping transfer tax planning can also be included in a SLAT.

Single Life SLAT

To accomplish the desired estate tax advantages of a traditional irrevocable life insurance trust, a SLAT that owns a single life policy should include these terms:

- The trust must be irrevocable and the insured mustn't have any "incidents of ownership" in the policy.
- Someone other than the insured must serve as trustee. The safest way to avoid the proscribed "incidents of ownership" is to include language that prevents the insured from serving as trustee of the trust that owns a policy on his life. Preferably, an independent trustee should serve as trustee; otherwise, a family member or close friend can take on this role. If the grantor's child serves as trustee, his rights to make discretionary distributions to himself should be limited by an ascertainable standard. In the case of a single life policy on the life of the grantor spouse, if the non-insured beneficiary spouse serves as trustee, again, discretionary distributions must be limited by an ascertainable standard.
- As a trust beneficiary, the non-insured beneficiary spouse's right to withdraw assets from a single life SLAT should be limited in any one year to the greater of \$5,000 or 5 percent of trust assets.
- The grantor's separate property should be used to fund the trust.

- The beneficiary spouse may be given a testamentary limited power of appointment (POA) to change the way the SLAT assets will pass to descendants.
- If each spouse insists on funding a SLAT for the other spouse, be very careful to include different substantive terms in each trust (that is, different beneficial interests, rights and powers) to avoid the reciprocal trust doctrine. (When the trust terms are virtually identical, this doctrine assumes each spouse has established a trust for his own benefit, which will result in estate inclusion of the trust property in the grantor's gross estate).

Benefits

A single life SLAT offers many advantages. Such benefits include:

- The SLAT will receive the policy death benefit free of income and estate taxes.
- As an irrevocable trust, a SLAT can protect assets from creditors of the beneficiaries.
- A SLAT allows distributions to the grantor's spouse and children during their lifetimes.
- The trustee of the SLAT can make tax-efficient distributions to the beneficiary spouse and children through policy loans and withdrawals (assuming the policy isn't a modified endowment contract (MEC)).

Considerations

Take the following issues into account when recommending a single policy SLAT to your client:

- Divorce or premature death of the beneficiary spouse would eliminate spousal access to the SLAT. It theoretically could be drafted so that if the grantor remarries, the new spouse will become a trust beneficiary (but it's unrealistic to think that any grantor would commit to this scenario while currently married to a different person). Perhaps the trustee could lend trust property to the grantor or his estate.
- Taking policy loans and withdrawals from a policy during the insured's lifetime can reduce the policy death benefit, will reduce the policy cash surrender value and could cause the policy to lapse prematurely.
- The policy shouldn't be structured as a MEC; otherwise, initial withdrawals and loans from the policy will be subject to income tax.

Survivorship Life SLAT

Instead of using a single life policy, a SLAT could own a survivorship policy, but extra care is required. Private Letter Ruling 9748029 demonstrates how to structure a survivorship life SLAT.

Only one of the spouses should establish a survivorship life SLAT, perhaps the spouse with the shortest life expectancy. The non-grantor spouse is named as primary beneficiary of the survivorship life SLAT, and the trustee could be authorized to make distributions to both the beneficiary spouse and the couple's children. To avoid creating incidents of ownership and inclusion of the policy death benefit in either spouse's gross estate, neither spouse should be allowed to serve as trustee.

The beneficiary spouse can have access to the policy cash value in the sole and absolute discretion of an independent trustee. While distributions of cash value to the beneficiary spouse under an ascertainable standard shouldn't be problematic, use of such a standard will create a problem if the beneficiary spouse tries to enforce the standard, and the trustee is forced to distribute the survivorship policy to the beneficiary spouse. This will cause the

beneficiary spouse to hold incidents of ownership in the policy, and there will be an estate inclusion problem. A professional, or if not, a family member or friend, should serve as trustee. It should be also possible for the beneficiary spouse to name an adult child as a “friendly” trustee, with the right to remove and replace the trustee.

The best approach is for the beneficiary spouse to have no POA (general or limited) or withdrawal rights over the trust property of a survivorship life SLAT. This means that the beneficiary spouse shouldn't be granted the right to withdraw annually the greater of \$5,000 or 5 percent of trust property and shouldn't be granted a *Crummey* withdrawal right in the survivorship life SLAT.

The grantor spouse must use his separate property to make all gifts to the survivorship life SLAT. The beneficiary spouse mustn't make any contributions of her separate property to the survivorship life SLAT (to avoid estate inclusion under Internal Revenue Code Sections 2036 and 2038). Nevertheless, the beneficiary spouse can split annual exclusion or lifetime exemption gifts made by the grantor spouse to the survivorship life SLAT.

What happens if the grantor spouse dies? How do you ensure that future premiums are made to the survivor life SLAT? The survivor life SLAT can be protected from a grantor spouse's early death by owning a single life policy on the grantor's life in an amount that would enable the trust to pay the remaining premiums. Or, the survivor life SLAT can borrow the necessary funds from the grantor spouse's estate.

The survivorship life SLAT gives a married couple access to the policy cash value through the beneficiary spouse. Access is flexible by naming one or more adult children as trustee. Initial policy cash value can be accessed tax-free (if the policy isn't a MEC). The leveraged policy death benefit will be received free of both income and estate tax.

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