SPOUSAL LIFETIME ACCESS TRUSTS? DO YOU TRUST YOUR SPOUSE?

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A hybrid method of combining both the flexibility and wealth building of an irrevocable life insurance trust and wealth preservation from creditors and predators is the use of spousal lifetime access trusts or SLATs.

The SLAT retains the characteristic elements of the policy benefits and maintaining the SLAT's assets outside of the grantor's estate.

The mixture of limited grantor accessibility to the trust is added by reason of the SLAT to the insurance trust structure and hence the term "spousal lifetime access trust".

The mechanics of formation of the SLAT is the same as an irrevocable life insurance trust. The grantor gifts the dollars to the trust which in turn pays the insurance premium owned by the trust. The trustee pays the premiums to the life insurance trust which provides cash value access and death benefits to the trust. The grantor uses the annual gift tax exclusion ($14,000.00) or part of the combined gift and estate tax lifetime exemption ($5,340,000) to contribute the premium dollars to the trust. The grantor's spouse receives a limited access to the trust assets and eventually the trust beneficiaries enjoy the residual trust assets including the death proceeds of the insurance policy in the trust. If the grantor transfers existing policies to the trust and dies within three years from the date of transfer then the death proceeds are included in the grantor's estate.

There are several Internal Revenue Code sections that frustrate the retention by the grantor of any rights or benefits when forming an irrevocable trust. This includes the retention of any incidents of ownership in the policy which includes the right to change beneficiaries, the right to assign the policy, the right to cancel or revoke an assignment of the policy, the right to pledge or collateralize a loan with the policy.

The SLAT is an irrevocable trust and the grantor may not retain any incidents of ownership in the policy. Someone other than the insured-grantor must serve as trustee but would allow for a spouse to serve in that capacity or a family member or independent person provided that they are not the insured. If the spouse is named as trustee then certain limitations should be placed in the trust on powers granted to the trustee whereby the spouse would also be a beneficiary and could make distributions to himself or herself and should be limited to distributions for an ascertainable standards such as health, education, support or maintenance. The spouse as beneficiary may also be granted the right to withdraw under the 5 and 5 powers which should be included in the trust. This means the spouse as a beneficiary may withdraw $5000.00 or 5% of the trust assets whichever is greater. For greater flexibility the trust could provide for discretionary distribution which enhances the protection from creditors and predators. This would necessitate the use of an independent or distribution trustee i.e. a close friend.

Ideally, the grantor's separate property should be used to fund the trust. This is because that the uninsured spouse would be considered a grantor and possibly cause inclusion of the trust property at the death of the uninsured spouse. This is of particular concern in community property and marital property states. The spouses should separate some of their community property into separate property prior to funding the trust. The distributions to the spouse should be deemed for that spouse's exclusive benefit to avoid arguments that the grantor retained an interest in the trust.

In the event that both spouses create SLATS then a careful review of the Reciprocal Trust Doctrine should be reviewed by experienced estate and tax counsel.

The major disadvantages are the possibility of death of the non-grantor spouse or divorce. If the grantor remarries then the new spouse may become a beneficiary. The trust can also provide for loans from the trust to the grantor.

A single life SLAT or survivor life SLAT may be used as an asset in the trust. In the event that the premium is based upon the amount of the gift exclusion by both spouses then a single life policy or first to die rider could be acquired to pay the scheduled premiums. If the grantor completes the funding of the survivorship trust then the additional policy could be cancelled.

The SLAT is an extremely beneficial estate and wealth preservation planning tool while allowing access to a permanent insurance policy's cash surrender values during the grantor's lifetime. It also can be combined with discretionary distributions to spousal and multi-generational beneficiaries while avoiding estate and generation skipping taxes and providing creditor protection to these beneficiaries. The estate and tax planning considerations in this type of planning is extremely complicated and qualified legal counsel should be consulted in the implementation of these plans.