2012 Estate Tax Planning Redux: Everyone Gets a SLAT

by Adam L. Sandler, Esq., Einhorn, Barbarito, Frost & Botwinick, PC – July 6, 2021

The COVID-19 pandemic has resulted in historically low interest rates, depressed values of certain assets and a need for increased federal revenue. When combined with the shift of power in Washington, this becomes a critical and advantageous time for clients to refocus on estate tax planning.

The Tax Cuts and Jobs Act of 2017 (TCJA) increased the federal estate and gift tax exemption from $5 million to $10 million, indexed for inflation. In 2021, that exemption is $11.7 million per person. Factoring in "portability" (the ability for a married couple to share in each other's unused exemption), a married couple can currently pass up to $23.4 million without such amount being subject to federal estate and gift tax. The individual exemption is scheduled to increase annually with inflation and then return to its pre-TCJA level of $5 million on Jan. 1, 2026 (approximately $6.5 million when adjusted for inflation).

However, a reduction in the exemption may happen even sooner and potentially by the end of 2021. President Biden's initial tax plan sought to reduce the estate tax exemption to $3.5 million per person, decouple the gift tax exemption at $1 million per person and increase the estate and gift tax rate from 40 percent to 45 percent. His American Families Plan does not call for those changes but seeks to abolish the basis adjustment ("step-up") for assets included in a decedent's estate under IRC§ 1014 and possibly institute an automatic realization of capital gains at death.

With the potential changes coming out of Washington, it is time to revisit estate tax mitigation strategies with clients who may have been pushing it off until closer to 2026, as well as those who would be affected under the Biden plan, if enacted. Clients should be thinking about capturing their unused exemption before it disappears and removing appreciating assets from their taxable estate.

Strategies for Clients

Telling clients to gift away their assets now to future generations is not always well received. After all, the client will not be around to benefit from any estate tax savings. When taxpayers faced a potential reduction of the exemption in 2012 from $5.12 million to $1 million, a popular vehicle emerged to enable them to capture the increased exemption while retaining "access" to the transferred assets — a Spousal Lifetime Access Trust (SLAT).

A SLAT is an irrevocable trust established for the benefit of the grantor's (aka settlor's) spouse, which may also include the grantor's descendants as discretionary beneficiaries. Once the grantor transfers assets to the SLAT, the grantor no longer owns those assets for estate tax purposes thereby losing his or her rights to enjoy them. However, because the SLAT is established for the benefit of the grantor's spouse, the spouse will have "access" to the trust assets. To the extent the spouse receives a distribution from the SLAT, the grantor may inadvertently benefit through the spouse's use or enjoyment of such distribution.

For clients who are unwilling to gift away assets or are concerned about the potential that any reduction of the exemption could be made retroactive to Jan. 1, 2021, tried and true "estate freeze"

strategies would assist clients in removing the appreciation of their assets from the estate without gifting away the underlying assets. Because SLATs are typically structured as “grantor trusts,” there should be no gain or loss recognized if the grantor sells an asset to the SLAT because the grantor is treated as the owner of the trust assets for income tax purposes under the grantor trust rules set forth under IRC § 671, et seq. This is what is commonly referred to as a sale to an Intentionally Defective Grantor Trust (IDGT).

The strategy is quite simple: the grantor would sell an interest in certain assets to a SLAT in exchange for payment of the assets’ fair market value. Instead of receiving cash, however, the grantor would receive a promissory note. This has the effect of “freezing” the value of the property included in the grantor’s estate to the face amount of the promissory note, plus the annual interest charged thereon. Interest would be imposed at the Applicable Federal Rate (AFR) as of the date of the sale. All of the income and appreciation of the assets in excess of the original value of the note, and interest charged thereon, would be captured in the trust and, thus, pass to the client’s intended beneficiaries with no estate and gift tax assessed on such income and appreciation.

Disclaimer: The potential passage of two Acts introduced in the Senate — For The 99.5% Act, introduced by Senator Sanders, and the Sensible Taxation and Equity Promotion (STEP) Act, introduced by Senators Van Hollen, Booker, Whitehouse, Warren and Sanders — could impact this type of planning.

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