

# Spousal Lifetime Access Trusts: Are They All They're Cracked Up To Be?



## Trusts and Estates Insights

*Why am I hearing so much about "SLATs" right now?*

*The federal gift and estate tax applicable exclusion (sometimes referred to as an "exemption") is currently the highest it has ever been: \$12.92 million per individual and \$25.84 million per married couple in 2023. However, if Congress does not act, these high exemption amounts will automatically "sunset" on January 1, 2026, reverting back to pre-2017 levels (indexed for inflation, the exemptions are projected to be approximately \$6.20 million per individual and \$12.40 million for married couples).*

Many married couples wish to take advantage of the elevated federal exemption amounts before they sunset, but are not yet ready to irrevocably transfer significant wealth to trusts for their children, grandchildren or other beneficiaries. An irrevocable transfer (or a "completed gift") is required in order to take advantage of the lifetime exemption amounts, which means the couple would no longer be able to use the transferred assets to support their own lifestyles and spending needs. These couples may want a more flexible trust structure that could allow for (i) continued access by one spouse (the "beneficiary spouse") to the assets transferred by the "gifting spouse" and (ii) the ability of the beneficiary spouse to change the provisions of the original trust instrument as circumstances warrant. A spousal lifetime access trust ("SLAT") may be the solution for these concerns.



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**A SLAT is a form of irrevocable trust that cannot be amended or terminated except under limited circumstances**



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## What is a SLAT and How Would I Create One?

A SLAT is a form of irrevocable trust that cannot be amended or terminated except under limited circumstances. The gifting spouse (often called the donor, grantor, settlor, etc.) transfers assets into the trust with the intention of removing the value of the transferred assets from the gifting spouse's estate for estate-tax purposes. Because the gifting spouse's exemption would be applied to the transferred assets, both the assets and any post-gift appreciation on them would be sheltered from federal estate taxes upon the deaths of the gifting spouse and the beneficiary spouse. Importantly, the transfer, once made, is also irrevocable. The gifting spouse must relinquish all control over and enjoyment in those assets in order for their value to avoid estate taxation upon the gifting spouse's later death.

Although the SLAT cannot benefit the gifting spouse, it can, as the name suggests, benefit the beneficiary spouse as well as other beneficiaries (such as children, grandchildren, other family members or friends), and this is one of its primary benefits. The authority of the trustee to make distributions to the beneficiary spouse and other beneficiaries can be flexible or restrictive. The beneficiary spouse may be given a limited "power of appointment" to redirect the remaining trust property upon his or her death and/or to rewrite the terms of the original trust if the family's circumstances have changed. Such powers of appointment can be quite broad if desired.

Bear in mind that because the gifting spouse's exemption was applied to the trust, the most tax-efficient result is for the beneficiary spouse not to request a distribution from the trust unless it is truly necessary. In this way, the SLAT's assets can increase in value during the lifetime of the beneficiary spouse and ultimately pass to the other beneficiaries without any further estate or gift tax. In addition, because SLATs are typically structured as so-called "grantor trusts" for income tax purposes, the gifting spouse remains personally responsible for paying all income taxes attributable to the trust assets, allowing the SLAT to grow income tax-free. If the gifting spouse also applies generation-skipping transfer ("GST") tax exemption at the time of the transfer, SLATs can be highly tax-efficient intergenerational wealth transfer vehicles.

To "fund" a SLAT, the gifting spouse would transfer assets in his or her individual name to the trust, and report those transfers as taxable gifts on a federal gift tax return, applying exemption so that no gift tax would be due. Almost any asset held in the gifting spouse's individual name can be used to fund a SLAT, including cash, marketable securities, real estate, life insurance, or closely held business interests. However, a SLAT should not be funded using jointly owned or community property. Non-marketable assets must be valued by a qualified appraisal as of the gift date for reporting purposes.

If a married couple is ready to transfer up to one exemption's worth of assets but not both, it is generally advisable to have one gifting spouse use all of his or her exemption, rather than have each spouse use half of their respective exemptions. This is because when the currently high exemptions sunset, the gifting spouse's prior use of exemption will reduce the post-sunset exemption amount remaining; in other words, it is a "use it or lose it" proposition, and is not subject to any clawback.

## Why Wouldn't I Want to Do This?

While SLATs can be used to take advantage of the elevated federal exemption, there are a number of important potential downsides that couples need to consider before moving ahead.

First and foremost, it is important to understand that the gifting spouse must give up all direct control over and access to the trust assets. Because the gifting spouse cannot be a trustee of the SLAT, he or she will not have any say in whether and when distributions will be made to the beneficiaries. And, as mentioned previously, the gifting spouse cannot be a beneficiary of the SLAT but may retain the ability to remove and replace the trustee with another independent trustee, who may or may not agree with the gifting spouse's views regarding the trust. Many couples who consider SLAT planning ultimately decide they are not comfortable losing this much control over their assets.

Second, remember that the purpose of a SLAT is to use the gifting spouse's currently elevated federal exemption before it disappears. As a result, the tax-planning benefits of a SLAT diminish if the beneficiary spouse receives significant distributions from the trust, thereby reducing the trust's ability to grow for the benefit of the other beneficiaries. If there is a reasonable likelihood that the couple will need access to the SLAT funds during the beneficiary spouse's lifetime, they may wish to consider funding the SLAT with less than the full exemption, or simply not funding a SLAT (or any irrevocable trust) at all.

On a related note, any indirect economic benefit that the gifting spouse may expect to be available to him or her through discretionary distributions to the beneficiary spouse would be eliminated if the beneficiary spouse dies prematurely or if the couple divorces. Therefore, it is critical for a couple to consider how the current dynamics of their marriage might change over time, and to share the same fundamental understanding of how a SLAT fits into their overall wealth-planning goals. Although it is possible for a SLAT's terms to eliminate an ex-spouse's beneficial interest, the couple may disagree on the use of such terms.

Finally, the flexibility given to the beneficiary spouse under the terms of the trust instrument (e.g., to receive principal and income distributions or to ultimately change the trust terms after the beneficiary spouse's death via a power of appointment) may become problematic if the beneficiary spouse's vision of how the SLAT should be administered diverges from the intent of the gifting spouse. The SLAT is irrevocable, but as the personal and financial situations of a couple change over time, the gifting spouse might experience "buyer's remorse" regarding the SLAT's original structure. And, even with modern options for trustees to modify, "decant," or otherwise restructure irrevocable trusts, it may not be possible for the gifting spouse's original wishes and views to be maintained.

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## Is There Anything Else I Should Consider if I Want to Move Ahead?

SLATs generally are “grantor trusts,” meaning that the gifting spouse (and not the trust) will be responsible for paying the income tax generated by the trust assets each year, even though the gifting spouse is neither a trustee nor a beneficiary of the trust. Gifting spouses need to be certain that their own personal income and assets will allow them to comfortably meet this tax obligation each year. Unlike other types of grantor trusts, SLATs generally cannot be crafted in such a way that grantor trust status can be “turned off” (at least for so long as the beneficiary spouse remains a beneficiary of the SLAT). Importantly, due to recent changes in tax laws, if the beneficiary spouse remains a beneficiary of the SLAT post-divorce, any distributions to the beneficiary spouse would not be income to that spouse, but instead would continue to be taxed to the gifting spouse due to the “grantor trust” nature of the SLAT, described above.

If both spouses wish to create SLATs, either the terms of each trust need to be substantially different or significant time should separate the creation of each trust to avoid the “reciprocal trust doctrine,” which, if applicable, would entirely nullify the transfer tax planning objective of SLATs. There is no safe harbor to rely upon, so the creation of dual SLATs – while not uncommon – necessarily involves some risk.

Last, but not least, it is important to remember that assets contributed to a SLAT will not receive a step-up in cost basis for capital gains tax purposes at the time of the gift or upon the death of the gifting spouse or beneficiary spouse. If appreciated assets are contributed to the SLAT or if the SLAT’s assets grow significantly over time, capital gains tax will eventually need to be paid when the appreciated assets are sold and will partially offset the transfer tax benefits of the SLAT. In contrast, if the couple were to retain those assets until their deaths, the assets would be subject to estate tax, offset by the then-effective federal estate tax exemption, but would, under current law, receive a full step-up in basis.

### Takeaway

Estate and financial planners are already bracing for a year-end scramble in 2025 as clients will inevitably race to preserve their gift and estate tax exemptions before they sunset. If the advantages conferred by SLATs would make sense for you and your family, we at Fiduciary Trust can work with your estate planning attorney and other tax advisors to establish and fund a SLAT during this window of opportunity. ■

