CUMMINGS & LOCKWOOD LLC

BACK-END SPOUSAL LIFETIME ACCESS TRUST

March 5, 2023

Authors: Robert L. Lancaster and Joseph A. Stusek

Naples Daily News Sunday Supplement

The historically high combined federal estate and gift tax exemption amount, currently $12,920,000 per individual in 2023, afforded by the Tax Cuts and Jobs Acts (the "TCJA") will sunset on December 31, 2025, absent further legislation from Congress, and be reduced to the pre-TCJA level of $5,000,000 (adjusted annually for inflation) per individual on January 1, 2026. This provides individuals a window of time to significantly reduce the size of their taxable estates by making large gifts of property using the increased exemption amount.

A familiar gifting strategy is for one spouse (the "Donor Spouse") to establish a "spousal lifetime access trust" (SLAT), which is an irrevocable trust for the benefit of the other spouse (the "Donee Spouse "). The Donee Spouse can receive distributions from the SLAT, and, thus, the Donor Spouse can benefit indirectly from such distributions. However, the problem that arises is if the Donor Spouse outlives the Donee Spouse. Under normal circumstances, the Donor Spouse cannot directly benefit from the SLAT.

Fortunately, the Florida Statutes were modified as of July 1, 2022 to permit the Donor Spouse to be a beneficiary of the SLAT after the death of the Donee Spouse (referred to as a "Back-End SLAT"). The Donee Spouse must be a beneficiary for his or her lifetime, even after divorce. Upon the death of the Donee Spouse, the statute mandates that the Donee Spouse is deemed to be the one who contributed property to the trust and not the Donor Spouse.

But for the recent change to the Florida Statutes, the Self-Settled Trust Doctrine effectively prevented a Donor Spouse from being a beneficiary of a SLAT because it subjected the assets of the SLAT to the Donor Spouse's creditors under Florida law, which caused federal estate tax inclusion in the Donor Spouse's estate. Another issue is whether the IRS would treat the Donor Spouse as having retained an indirect interest in the trust, thereby causing federal estate tax inclusion. The IRS has issued several rulings addressing this issue that essentially boil down to whether there is an understanding or preexisting arrangement with the Donor Spouse on how trust assets will be distributed. Therefore, it is imperative that no such understanding or prearrangement exists between the Donor Spouse and a third party that such party will add the Donor Spouse as a beneficiary or that a Trustee will make distributions to the Donor Spouse should the Donor Spouse become a beneficiary. The most significant risk to the creation of a Back-End SLAT is that it lacks specific support under the Treasury Regulations. The IRS may closely review trusts using the technique and could even decide to subject them to the IRS's anti-abuse regulations, which could have severe adverse tax consequences.

Though not a definitive list, a Back-End SLAT should provide the following: (i) the Donee Spouse and/or a Trust Protector have discretion to add the Donor Spouse as a beneficiary of the SLAT, effective after the death of the Donee Spouse; (ii) after the death of the Donee Spouse, only an Independent Trustee in his or her absolute discretion may make distributions to or for the benefit of the Donor Spouse; (iii) a Trust Protector have the power to remove the Donor Spouse as a beneficiary; and (iv) the Donor Spouse should not have the ability to remove and replace the Trustee.

Even with a carefully-drafted Back-End SLAT, the IRS may still try to include the trust assets in the Donor Spouse's estate, but, for some, it may be worth the risk to be a future, potential beneficiary.