

OCTOBER 2017 NEWSLETTER

POZZUOLO RODDEN, P.C.
COUNSELORS AT LAW
THE BYE-BENSON HOUSE
2033 WALNUT STREET, PHILADELPHIA, PA 19103
215-977-8200

www.pozzuolo.com



THE SPOUSAL LIFETIME ACCESS TRUST ("SLAT") AS AN ADVANCED ESTATE PLANNING TECHNIQUE

FIRM ANNOUNCEMENTS:

A. Pozzuolo Rodden, P.C. is pleased to announce that Lea Thierman, Esquire has been hired as an associate attorney at the firm practicing primarily in the area of estate planning and estate administration. Ms. Thierman graduated from Temple University-Beasley School of Law, with a Master of Law (LLM) in taxation. She received her Juris Doctorate at Rutgers School of Law, Camden, New Jersey. After law school, Lea Thierman worked for a small law firm in southern New Jersey specializing in estate planning and estate administration. Lea is admitted to practice in Pennsylvania and New Jersey.

B. BLOGS

1. The following are a few of the business, tax, employment, estate planning and business litigation blogs posted on our main website www.pozzuolo.com during the past month:

- a. Treatment Of Step Children And Out Of Wedlock Children In Your Will;
- b. Employment Law-Policies About Workplace Dating;
- c. Tax Law- Don't Take The Bait; and,
- d. Commercial/Business Negotiation Lessons, Strategies And Techniques, Part II-Due Diligence.

Please visit our website www.pozzuolo.com for more information on these and other relevant business, tax, estates and employment topics.

2. The following are a few of the family law blogs posted on our family law website www.pozzuolofamilylaw.com during the past month:

- a. Parent Who Was More Available For Child Was Awarded Primary Physical Custody;
- b. Venue For Child Custody Cases;
- c. Child Support; College Education, A Child Can Intervene In Parents' Divorce Seeking Money for College; and,
- d. Remarriage And Estate Planning?

Please visit our website www.pozzuolofamilylaw.com for more information on these and other relevant family law topics.

Please visit our Facebook page to read all of our past and future blogs: Pozzuolo Rodden, PC

C. EDUCATIONAL SEMINARS ON YOU TUBE AND WEBSITE:

Pozzuolo Rodden, P.C. is pleased to announce you can view the following seminars taught by Joseph R. Pozzuolo and/or Jeffrey S. Pozzuolo at "Pozzuolo Rodden, P.C.- You Tube"

*The Negotiation and Documentation of Commercial Real Estate Loan Documents

*The Fundamentals of Starting a Business

*How Middle Income Families Should Plan for Retirement

**THE SPOUSAL LIFETIME ACCESS TRUST ("SLAT") AS AN
ADVANCED ESTATE PLANNING TECHNIQUE**

A Spousal Lifetime Access Trust ("SLAT") is a form of "bypass trust" created during life rather than at death. What this means is that in advanced estate planning the two tax savings spousal trusts normally created at death are: 1) the marital deduction trust; and, 2) the unified credit/credit shelter/family/non-marital/B/bypass trust (Each of these trusts are one and

the same, identical trusts and how it is identified is totally dependent on the drafting attorney's law school professor). The bypass trust is normally funded up to the then federal estate tax exemption amount as this is the amount that passes federal estate tax free. Then for any excess assets, the marital trust is funded for the surviving spouse to postpone federal estate taxes on such remaining assets until the second spouse dies. The idea is if there are assets in excess of the federal estate tax exemption, the surviving spouse is supported initially with the marital trust assets and hopefully the entire bypass trust plus all appreciation and growth will be distributed to the children estate tax free at the surviving spouse's death. If the marital trust does not become funded or becomes exhausted, the surviving spouse is supported by the income and principal distributions from the bypass trust for his/her health, support, education and maintenance needs ("HEMS").

How the SLAT differs from the standard deathtime trusts is that a SLAT is funded PRIOR to your death instead of being funded at your death through either your Will or a Revocable Trust. A SLAT includes a number of configurations whereby your spouse may receive certain distributions from such trust during your lifetime, but care must be taken that the SLAT assets do not become includable in your Gross Estate. That is where and how the "Spousal Lifetime Access" received its name.

What are the benefits of a SLAT?

The SLAT was originally popularized in 2012 when the federal estate tax exemption amount was scheduled to be reduced back down to \$1 million. A SLAT was an advanced estate planning strategy to lock in the higher \$5 million federal estate tax exemption of 2012 before it was reduced to \$1 million dollars and the federal estate tax rate was to be increased from the then 35% to the anticipated 55%. In 2013, the \$5 million estate tax exemption was retained (with inflation) and the tax rate was raised to only 40% versus 55%. Although the primary purpose of the SLAT planning was mooted, there are still certain federal estate tax reasons for creating a SLAT:

1. Access to the Gifted Assets: Under a normal irrevocable trust, if you have a right to receive back or receive benefits of the assets transferred to the trust, then the gift of the assets to the trust are not completed and are includable in your federal Gross Estate for federal death tax purposes. With a SLAT, your spouse may be provided distributions in certain circumstances while the assets will still be outside of your Gross Estate. This means you get the best of both worlds where it is within your indirect reach, if necessary, but the assets are outside of your Gross Estate for federal gift and death tax purposes/. However, care needs to be taken to assure these assets are not includable in your Gross Estate for death tax purposes such as limiting principal distributions for your spouse "during your lifetime" to the sole discretion of an independent trustee.
2. State Death Tax Advantages: While most states may impose a form of an estate or inheritance tax (or both) if the bypass trust is funded at death, using a SLAT may avoid

such taxes as many states do not have a state gift tax. For example, in Pennsylvania, the inheritance tax is 4.5% for lineal heirs, 12% for siblings and 15% for other heirs. This means if assets are gifted properly to a SLAT during the donor's lifetime, then no state death taxes would be due at his/her death. For a \$5 million estate, this means a possible savings of \$225,000 to \$750,000.

3. Growth and Income Accumulation Outside of the Estate: The SLAT has the estate tax benefit that once an asset is outside of your Gross Estate, then all the income, appreciation and growth passes outside of your Gross Estate for federal gift and death tax purposes. That means, if you gift \$3 million now to a SLAT and the SLAT receives \$3 million of income, appreciation or growth over the remaining 10 years of your life, then effectively you have gifted \$6 million dollars while only using \$3 million of your federal estate and gift tax exemption. This leaves an additional \$2.49 million that can be given estate and gift tax free. That is a transfer of \$8.49 million tax free. If this was given at death, assuming a \$5.49 million estate tax exemption, then only \$5.49 million will be given tax free and the remaining \$3 million will be subject to federal estate taxes at a marginal 40% rate or \$1,200,000.
4. Leveraging Valuation Discounts: In the same vein of attempting to use your federal estate and gift tax exemption to the maximum, you may be able to give gifts of business interests, real property holdings or other assets at a discounted value. By this, when valued for gift and estate tax purposes, the value will be discounted anywhere from 20% to 40% of the fair market value potentially due to lack of marketability, lack of transferability, and lack of control discounts. This means instead of only transferring \$5.49 million under the federal estate and gift tax exclusion, with a 40% valuation discount you could transfer \$9.15 million tax free. This coupled with the growth, appreciation and income outside of the Gross Estate can be tremendous advanced estate planning strategy.
5. Use of the Gift Tax Exemption: By gifting during your life you are also able to use the federal annual gift tax exclusion of \$14,000 per year assuming Crummy powers are used. This means if you are married and you are combining your federal annual gift tax annual exclusion with your spouse and have three children with seven grandchildren, you can remove \$280,000 (2 donors x \$14,000 exclusion x 10 giftees) from your Gross Estate tax free into the SLAT every year. This is \$2.8 million every ten years.
6. Asset Protection: A SLAT may also be created to provide a certain level of asset protection from creditors as long as it is properly created and not set up in anticipation of creditor claims. For instance, you can provide an independent trustee with sole discretion on distributions whereby the creditors of yourself and your spouse will not be able to reach the trust assets. This helps ensure the assets will be distributed and flow to your future heirs especially if something financially catastrophic happens.

What are the Risks?

1. **FUNDING:** With both spouses being approximately the same age and fully employed during his/her working lifetime, a major risk of a SLAT is many times it is not readily apparent which spouse will die first. In such a situation spouses may not be certain which spouse should fund the SLAT and which spouse should receive benefit of the SLAT. For traditional bypass trusts, spouses will create reciprocal trusts whereby each spouse will set up a marital trust for his/her spouse if he/she survives him/her, and a bypass trust for the minor children and surviving spouse. The benefit of this is the joint assets transfer by law to the benefit of the surviving spouse for his/her support regardless of who dies first. The issue with a SLAT is if a husband creates a SLAT for his wife, the husband may indirectly have access to the assets during both of their lives, and if the husband dies first the wife is supported for the remainder of her life. However, if the wife dies first, then the husband loses all indirect access to the SLAT and may not be supported if he needs such assets for HEMS. Accordingly, it is prudent to create for SLAT with either excess assets owned by the donor so the donor is supported in the event the donee spouse dies first, or set the SLAT up to benefit an older spouse or one in poor health.

RECIPROCAL FUNDING DOCTRINE: One way around this funding conundrum is the husband and wife could create reciprocal SLATs for the benefit of each other. However, the IRS has something called the reciprocal trust doctrine. This means the SLAT created by the husband for his wife will be treated as if the wife created it for herself and likewise for the SLAT created by the wife for her husband. This means the assets where a spouse is the beneficiary of the SLAT would be pulled back into such beneficiary spouse's Gross Estate losing the federal death tax benefits of the SLAT.

Therefore, certain steps need to be taken to avoid the reciprocal trust doctrine such as different trustees or co-trustees, different beneficiaries, different powers, funding with substantively different assets, or even spacing out the creation of each SLAT. Also, if it is apparent that one spouse is older or in worse health than the other then one SLAT can be set up from the older or less healthy spouse by the younger or healthy spouse.

2. **Divorce:** The other major drawback is the risk of divorce. Under a standard Will, upon divorce, unless stated otherwise, the ex-spouse is treated as if predeceased and does not receive an interest under the Will. Under a SLAT, that spouse will still have his/her interest in that the SLAT has been funded. The risk of divorce is 1) you lose indirect access to the trust assets as the ex-spouse likely will not share it; and 2) you created a funded trust that supports your ex-spouse when you may need or want the assets to support a new spouse or even your children. To protect against such you may want to include a provision that a divorce will treat your ex-spouse as predeceased and that after a divorce the trust assets are for the health, support, maintenance and education of your joint children. However, it may be difficult to get a future spouse an interest to such trust assets absent a trust protector and special language.

In summary, SLATs provide a potential of many great tax and asset protection advantages, but

may come at the cost of a potential disposition mismatch. While a SLAT may not be for everyone, every estate planning decision to an extent balances taking tax advantages versus a desired disposition of assets. Some people may view the tax advantages to outweigh any possible risks of undesirable dispositions, especially if such undesirable dispositions are properly drafted around. Also, SLATs may be important if we face a situation in the future where the federal estate and gift tax exemption is reduced from the current \$5.49 million so it can serve its originally intended purpose to preserve an abnormally high federal estate and gift tax credit. It is another tool to be aware of and if it sounds like it may fit yourself, then we are always here to help.

If there are any legal questions you would like this office to answer in the future, please email the question to us at info@pozzuolo.com. Each month, the question with the most relevance to our privately held business clients, advisors, and friends will be answered in our monthly newsletter. The questions can relate to any of the areas practiced by this office including business planning and transactions, corporate law, commercial litigation, employment law and litigation, commercial real estate and development, construction law and litigation, estate planning, estate administration, tax and pension law, family law litigation.

PUBLICATIONS

All of the following professional publications and past newsletters written by attorneys of this office are available by clicking here: http://pozzuolo.com/Pubs_Articles.shtml

Corporate/Tax Articles

- Bankruptcy - How To Prevent It And How To Cope With It Should It Happen To Your Business
- Deferred Compensation Rewards And Retains Key Employees
- Design Buy-Sell Agreements For Maximum Utility
- How An S Corporation Avoids The Double Taxation Incurred When Excessive Compensation Is Treated As A Dividend
- How Mortgage Lenders Should Draft Broker Agreements To Avoid RESPA Violations
- How To Look, Act And Sound Like A Professional Corporation
- How to Structure a Suitable Buy-Sell Agreement
- How To Use Non-Qualified Deferred Compensation Arrangements As A Business, Retirement And Tax Planning Tool
- Money Purchase Pension Plan Falls Out Of Favor
- Protecting A Client's Business From Unfair Competition Using Restrictive Covenants
- Structuring Loans From Qualified Plans - How To Handle The Strict Tax Rules
- What Type of Qualified Corporate Retirement Plan Best Serves Your Business, Tax And Retirement Needs
- Why An Employment Contract Is Mandatory

Estate Planning Articles

- Adapt Estate Planning Strategies to Fit the Needs of Same-Sex Couples
- College Funding Tool Offers Estate Planning Advantage
- Diversify Strategies For An Effective Estate Plan
- Divorce and Estate Planning
- Divorce Raises The Need For Performing An Estate Planning Review
- Drafting The Durable Power Of Attorney For Wealth Protection Purposes
- Estate Planning For Pet Owners
- Remarriage Situations Can Raise Special Estate Planning Considerations
- Six Proven Estate Planning Techniques
- Special Needs Trust - An Estate Planning Tool For The Disabled
- The Limited Liability Company -A Sophisticated Tool For Estate Planning
- Using Trusts To Maximize Family Protection And Minimize Estate Tax
- Why Living Wills- Advance Directives Are An Essential Part Of Estate Planning

Actual resolution of legal issues depends upon many factors, including variations of facts and state laws. This newsletter is not intended to provide legal advice on specific subjects. It is to provide insight into legal developments and issues. You should always consult with legal counsel before taking any action on matters covered in our updates.

This newsletter is courtesy of Pozzuolo Rodden, P.C.

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