Two Estate Planning Strategies to Help Protect Wealth

A goal of estate planning is to maximize the wealth that is passed on to one's heirs. The lifetime gift tax exemption is at an all-time high of $12.92 million per individual and $25.84 million per couple. Under current law, however, these limits are scheduled to decrease to $5 million per individual and $10 million per couple, indexed for inflation, after December 31, 2025. For this reason, wealthy couples may want to consider leveraging a Spousal Lifetime Access Trust or an Irrevocable Life Insurance Trust to help minimize estate taxes and protect wealth.

A Spousal Lifetime Access Trust, also known as a SLAT is an estate planning strategy that enables married couples to maximize the lifetime gift tax exemption. A SLAT is an irrevocable trust that one spouse establishes for use by the other spouse, who is a beneficiary of the trust.

Once a SLAT is established, the donor spouse transfers assets to the SLAT as a gift. The value of the transferred assets counts against the donor's lifetime gift tax exemption, and the transferred assets are then excluded from both spouses' estates for estate tax purposes. Even though the current lifetime gift tax exemption amounts are scheduled to sunset by 2026, the Treasury Department has confirmed that taxpayers can utilize the full exemption now without fear of clawbacks after 2025.

Once the donor spouse transfers assets to the SLAT, they lose legal ownership, control, and access to those assets. However, they may have access to or benefit from the assets indirectly through their spouse. SLATs allow spouses to access the funds immediately, even while the donor spouse is still alive.

SLATs can be a powerful estate planning tool, and it is not uncommon for each spouse to create a SLAT for the other. However, spouses must not violate the "reciprocal trust doctrine", which on a very basic level, requires the two SLATs to be sufficiently different from one another. In addition to the reciprocal trust doctrine, there are other important rules that pertain to the ownership of assets transferred to the trust and the timing of the transfer of those assets. Your advisor can help ensure you're adhering to all rules.

There are two things to consider about SLATs. First, a SLAT is a grantor trust, and as such, the donor spouse, known as the grantor, pays tax on any income generated by the assets in the trust. Second, a SLAT is irrevocable so it cannot be altered nor amended. If a couple gets divorced, the ex-spouse will continue to be the beneficiary and the donor spouse will still have to pay income taxes on any trust earnings from that trust.

Another estate planning tool to help protect wealth is an Irrevocable Life Insurance Trust, also known as an "ILIT". An ILIT is an irrevocable trust with a life insurance policy as the main asset. The policy is typically used to help pay estate taxes on the value of assets in an estate that exceed the lifetime gift tax exemption.

Like a SLAT, an ILIT is a grantor trust and thus, the person who creates the ILIT is referred to as the Grantor. The Grantor may transfer an existing life insurance policy into the trust, or the trust may purchase a new life insurance policy. Regardless, once the trust owns the life insurance policy, it is considered outside the Grantor's control and will not count toward their taxable estate.

Life insurance policies must be transferred to an ILIT at least three years before the Grantor's death; otherwise, the life insurance proceeds may be included in the Grantor's taxable estate. To bypass the 3-year rule, an ILIT that has existed for at least three years can directly purchase the life insurance policy instead of transferring an existing policy into the trust.

You can take advantage of the annual gift tax exclusion by using a tool known as the Crummey Power. With Crummey powers, annual insurance premiums paid by your ILIT may qualify for the annual gift tax exclusion, up to $15,000 currently. By doing so, the annual premium payments will be deductible in addition to the asset bypassing inheritance taxation.

Also, if minor children are named as beneficiaries of the policy, it is a good idea to designate a trustee who will be responsible for complying with the terms of the trust and managing the assets on behalf of the minors. Otherwise, a court may have to appoint a conservator which can be a lengthy, costly, complicated process.

As you can see, a SLAT can help maximize a married couple's lifetime gift tax exemption and an ILIT can help an individual or married couple pay estate taxes on assets that exceed the lifetime gift tax exemption. Both strategies are based on the use of an irrevocable trust and thus come with other benefits to consider.

An irrevocable trust can be used to protect youthful beneficiaries from unexpected losses or mismanagement of funds. When creating the trust, the Grantor can specify how, when and to whom distributions will be made.

An irrevocable trust also provides certain legal protections against creditors because the beneficiaries do not legally own the assets in the trust, nor do the beneficiaries control how funds are distributed.

Final Thoughts

The purpose of the document is to provide a brief overview of a Spousal Lifetime Access Trust and an Irrevocable Life Insurance Trust. There are of course many other details beyond the scope of this video and we suggest meeting with one of our expert advisors to discuss how these strategies might help your individual situation.

If you would like to discuss your estate plan and strategies for minimizing taxes and preserving assets, please contact our office. We're always happy to help.

About Olsen Thielen

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Olsen Thielen was founded on the belief that personal attention, trust, and quality service were the key elements to helping our clients succeed. As we celebrate our centennial, that commitment remains stronger than ever. Our longevity and growth can be attributed to building strong relationships with our clients and continuing to earn their trust.

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