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Opening up to SLAT opportunities

Estate tax planning can become complicated when multiple parties are involved. For example, you may be concerned about providing assets to a surviving spouse of a second marriage, while also providing for your children from your first marriage. Of course, you also want to take advantage of favorable estate tax provisions in the law.

Fortunately, there's a relatively simple way to meet your objectives with few dire tax consequences. It's commonly called a spousal lifetime access trust (SLAT).

A SLAT in action

Essentially, a SLAT is an irrevocable trust established by a grantor spouse for the benefit of the other spouse — called the beneficiary spouse — plus other family members, such as children and grandchildren. The beneficiary spouse is granted limited access to the trust's funds.

As a result, the assets generally are protected from the reach of the beneficiary spouse's creditors. This ensures that the remainder beneficiaries — namely, the children and grandchildren — will have a nest egg to rely on.

According to the SLAT terms, lifetime distributions are made to the beneficiary spouse to meet his or her needs. Preferably, if other funds are available to the beneficiary spouse outside of the trust, those funds are used first instead of making regular distributions to the spouse. Otherwise, distributions from the SLAT to the beneficiary spouse will reduce the trust's effectiveness over time.

Favorable tax provisions

One of the primary attractions of a SLAT is that it's designed to minimize federal tax liabilities. First, the transfer of assets is treated as a taxable gift, but it can be sheltered from gift tax by a combination of the annual gift tax exclusion ($15,000 for 2021) and the gift and estate tax exemption ($11.7 million for 2021).

However, be aware that use of the exemption during the grantor spouse's lifetime reduces the available estate tax shelter at death. In addition, remember that the exemption is currently scheduled to revert to $5 million (adjusted for inflation) after 2025. And the new administration in Washington could further dilute this benefit.

Second, assets transferred by the grantor spouse to a SLAT are removed from his or her taxable estate. Thus, estate taxes aren't a concern, thereby allowing the remaining estate tax exemption to be used for other assets.

Third, a SLAT is considered to be a "grantor trust" for income tax purposes. In other words, when a grantor spouse establishes a SLAT for the benefit of the beneficiary spouse, the trust's taxable income is reported on the grantor's personal tax return, but the trust entity pays zero tax. This may be advantageous because the assets can compound inside the trust without any income tax erosion. On the death of the grantor spouse, the trust is required to pay income tax.

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Other planning considerations

If the beneficiary spouse dies first or you get divorced, you won't have access to the funds in the SLAT, regardless of your needs. Because of this possible scenario, it's usually best to transfer only those assets that you can reasonably afford to live without. In this way, you're protecting yourself without harming your spouse.

Be careful with reciprocal trusts

Typically, a spousal lifetime access trust (SLAT) is established by a grantor spouse for a beneficiary spouse. It's a one-way street. But SLATs may also be used on a reciprocal basis. In other words, each spouse can set up a SLAT for the benefit of the other.

However, bear in mind that under special tax rules for reciprocal trusts, the SLATs must be different in a meaningful way. If they're identical, the assets will be included in the taxable estate of the grantor. Typically, this result can be avoided if the trusts are set up at different times with varying provisions and are funded separately.

As mentioned above, the transfer of assets to a SLAT is a gift, so the grantor must file a federal gift tax return. Because his or her spouse is a beneficiary of the trust, gifts generally aren't eligible for gift splitting where one-half of the gift is reported by each spouse. Accordingly, you might fund the trust with an amount no higher than the lifetime gift tax exemption, which still gives most people plenty of leeway.

Finally, don't forget that a SLAT is an *irrevocable* trust. Thus, once the grantor spouse transfers assets to the trust, he or she can't get them back.

Look at the big picture

Estate planning is about more than just taxes. Factor in all the relevant financial and personal factors before you commit to a SLAT. Your estate planning advisors can provide guidance as to whether this technique makes sense for your situation. •

Thinking of moving abroad?

Consider the estate tax planning implications before relocating

Suppose you're contemplating a bold move — literally: pulling up stakes and moving to a foreign country. There are many possible reasons for this drastic change of scenery. For example, you may be enticed by a new career opportunity, looking to retire to a warmer climate or wanting to live closer to loved ones.

Regardless of whether you're targeting a move "across the pond" or to a tropical paradise or elsewhere, be aware of the estate tax planning implications.

Income and estate tax ramifications

The main thing to know is that you'll still owe U.S. income tax if you're a U.S. citizen, even if you're earning the money abroad. The reason: The United States taxes you on your worldwide income, not just your U.S. income. Because you'll likely also owe income tax to the foreign country where you reside, you're effectively facing a double tax hit.

At least you can usually offset some U.S. income tax with a credit for taxes paid to a foreign country. Furthermore, you may qualify for a foreign earned income exclusion of $108,700 in 2021. To qualify, you must spend at least 330 days out of the country during a 12-month period. Further, you may be eligible for a foreign housing exclusion. And, if the country where you're residing has a binding treaty with the United States, you may benefit from a reduced tax rate there.

Similarly, you can't avoid gift and estate tax consequences just by moving abroad. As with income tax, your worldwide assets are still subject to federal gift and estate tax. So, if you buy a home abroad and suddenly die, the home is included in your taxable estate. Again, depending on the law of the foreign country, it's a double tax whammy.

Renouncing your citizenship

One possible way to avoid double taxation is to renounce your citizenship. This isn't a decision to be made lightly, especially if you envision returning full-time to the United States at some point. But it does put you in position to obtain some tax relief.

When you become an expatriate, you no longer have to pay income tax on worldwide income. Your U.S. tax obligations are limited to earnings from sources within or connected to the United States. This may reduce your overall income tax exposure. Comparable rules apply to your taxable estate. But you don't simply get a free pass if you're treated as a "covered expatriate" for tax purposes.

Notably, you'll be assessed an exit tax if you're still earning a living and you were a U.S. citizen or permanent resident for at least eight of the last 15 years. For 2021, the exit tax applies to an expatriate who:

- Has had, for the last five years, an average income tax liability exceeding $172,000,
- Has a net worth of $2 million or more, and
- Fails to certify compliance with all U.S. tax obligations for the preceding five years.

Briefly stated, covered expatriates are treated as if they'd sold all their worldwide assets at fair market value. It's as if you passed away just before moving day. This can result in a

significant tax liability, especially when you add in the value of retirement accounts.

Saving grace: There are several key exceptions to the exit tax. The most prominent is a generous inflation-indexed exclusion on unrealized gain ($744,000 for 2021).

Finally, if you renounce your citizenship, you forfeit the benefit of the gift and estate tax exemption. For 2018 through 2025, the exemption is $10 million, indexed for inflation ($11.7 million in 2021). Instead, you're stuck with a relatively paltry $60,000 exemption for non-residents.

Other considerations

Renouncing your citizenship may have other implications unrelated to or tangential to taxes. Depending on the jurisdiction, a will created and executed in the United States may no longer be legally binding in the foreign country. Plus, other estate planning documents might be affected by foreign laws, defeating your intentions. This could also have an impact on gift and estate taxes.

Another potential consequence is that trusts often don't travel well. For instance, in some countries trusts may be taxed at both the recipient and trust levels. Accordingly, you may need to investigate alternative planning opportunities such as use of direct gifts, 529 plans or other vehicles suitable to the particular jurisdiction.

Don't make any rash decisions

Conduct a thorough review of your assets — including earnings, real estate, retirement accounts and other holdings — and determine the repercussions of a move abroad. Contact your estate planning advisor for assistance. •

Family advancement sustainability trust

A flexible trust that can achieve many estate planning goals

While, ultimately, you create an estate plan to meet technical objectives, such as minimizing gift and estate taxes and protecting your assets from creditors' claims, you should also consider "softer," yet equally critical, goals. Because you've spent a lifetime building your wealth, it's important to educate your children or other loved ones on how to manage wealth responsibly. In addition, you may want to promote shared family values and encourage charitable giving. Using a "family advancement sustainability trust" (FAST) is one option to achieve these goals.

Creating a leadership structure

It's not unusual for the death of the older generation to create a leadership gap. A FAST can help fill this gap by establishing a leadership structure and providing resources to fund educational and personal development activities for younger family members.

For example, a FAST might finance family retreats and educational opportunities. It also might outline specific best practices and establish a governance structure for managing the trust responsibly and effectively.

Dissecting a FAST

Typically, FASTs are created in states that 1) allow perpetual, or "dynasty," trusts that benefit many generations to come, and 2) have directed trust statutes, which make it possible to appoint an advisor or committee to direct the trustee with regard to certain matters. A directed trust statute makes it possible for both family members and trusted advisors with specialized skills to participate in governance and management of the trust.

A common governance structure for a FAST includes four decision-making entities:

1. An administrative trustee, often a corporate trustee, that deals with administrative matters but doesn't handle investment or distribution decisions,

2. An investment committee — consisting of family members and an independent, professional investment advisor — to manage investment of the trust assets,

3. A distribution committee — consisting of family members and an outside advisor — which helps ensure that trust funds are spent in a manner that benefits the family and promotes the trust's objectives, and

4. A trust protector committee — typically composed of one or more trusted advisors — which stands in the shoes of the grantor after his or her death and makes decisions on matters such as appointment or removal of trustees or committee members and amendment of the trust document for tax planning or other purposes.

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Exploring funding options

It's a good idea to establish a FAST during your lifetime. Doing so helps ensure that the trust achieves your objectives and allows you to educate your advisors and family members on the trust's purpose and guiding principles.

FASTs generally require little funding when created, with the bulk of the funding provided upon the death of the older generation. Although funding can come from the estate, a better approach is to fund a FAST with life insurance or a properly structured irrevocable life insurance trust. Using life insurance allows you to achieve the FAST's objectives without depleting the assets otherwise available for the benefit of your family.

Not so fast

If your children or other family members are in line to inherit a large estate, a FAST may be right for you. Properly designed and implemented, this trust type can help prepare your heirs to receive wealth and educate them about important family values and financial responsibility. Your estate planning advisor can help determine if a FAST should be part of your plan. •

ESTATE PLANNING PITFALL

You haven't provided a password list to relatives

If you're like most people, you've probably encouraged your elderly relatives to list all of their assets and contact information, including passwords to online accounts. This will enable you or other family members to access vital information at times when you must act on their behalf.

But what about yourself? If you're relatively young and in good health, you may have ignored the possibility that you could suddenly and unexpectedly become incapacitated or even die. In a worst-case scenario, your loved ones will be locked out of your accounts. Don't make this mistake.

Typically, you can supplement your will by providing a list of instructions or a similar document. Use this opportunity to list passwords for logins to email accounts, websites, financial and retirement accounts, and social media accounts. This will save your family members a lot of hassle at a time when they're likely to be emotionally wrought or grieving.

If you want to go the extra mile, use a password manager so that they'll have "one-stop shopping" for all your logins. You can find a number of reputable options at a reasonable cost for year-round protection. Alternatively, you might use a password-protected spreadsheet. In either event, make sure this important information is available to the people who will need it the most.

Finally, keep the information updated. It won't do anyone any good if the passwords are obsolete.

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