Two Ideas for the New Year

Spousal Lifetime Access Trusts ("SLAT") & Qualified Personal Residence Trusts ("QPRT")

In November 2018, the IRS announced anti-clawback regulations regarding the current federal estate and gift tax exemption amounts. This means that a person using their lifetime federal exemption amounts will not be penalized if the current record high exemption amounts decrease at some point in the future. The Tax Cuts and Jobs Act of 2017 significantly increased the exemptions, from a base exemption of $5,000,000 per individual to a base exemption of $10,000,000 per individual, which is indexed for inflation to $11,580,000 for 2020. However, the Tax Cuts and Jobs Act is set to expire on December 31, 2025, and these exemption amounts will return to a base exemption of $5,000,000 per individual, which is likely to be indexed for inflation to $6,300,000.

Below are two ideas for using your current lifetime exemption:

1. A **Spousal Lifetime Access Trust ("SLAT")** is an effective way to utilize current tax exemption amounts before they disappear.

SLAT Overview

- Grantor Spouse creates an irrevocable trust with the other spouse as beneficiary and trustee.
- Grantor Spouse gifts assets to the SLAT and files a gift tax return, using some (or all) of the lifetime gift tax exemption.
- Trustee can make distributions from the SLAT to Beneficiary Spouse during their lifetime for health, maintenance and support.
- SLAT contains directions on how assets will be distributed on death of Beneficiary Spouse, i.e., to children or trusts for their benefit.

SLAT Advantages

- **Use of Current Lifetime Gift Tax Exemption**. As mentioned, the “anti-clawback” has created a “use it or lose it” opportunity. The SLAT permits individuals to use their significant current lifetime gift tax exemptions now even though they will be reduced in the future.
- **Tax Reduction**. Once assets are gifted to the SLAT, the gifted assets can grow estate tax free and are not included in either spouse’s taxable estate at death. For example, if an individual gifts $5M to a SLAT and the gifted assets grow in size to $20M, the entire amount escapes the estate tax. If the same individual otherwise retained the same $5M and the assets grew to $20M at death, the current estate tax exemption may only cover the first $11.4M. The remaining amount could be subject to federal estate tax (currently 40% or $3,440,000 in additional tax).
- **Wealth Protection**. SLAT assets are generally protected under state law from both spouses’ creditors. SLATs create significant wealth protection from lawsuits against the grantor, trustee and beneficiaries, potentially protecting the wealth in the event children or grandchildren divorce or remarry.
- **Multiple Beneficiaries**. Though its name may suggest otherwise, there may be multiple beneficiaries in addition to a grantor’s spouse. This same technique is available for children, grandchildren or other beneficiaries. The utilization of a SLAT coupled with a generation-skipping plan design could literally save families *millions* of dollars in estate taxes over several generations.

SLAT Disadvantages

- **Loss of Control and Access**. The grantor transferring assets to a SLAT for the benefit of his or her spouse and descendants loses control and access to the trust assets and must be comfortable with the amount transferred to the trust.
- **Accounting to Descendants**. In some states, children or descendants may be entitled to information concerning the SLAT and its assets (referred to as a trust accounting).

2. In addition to a SLAT, a **Qualified Personal Residence Trust (or “QPRT”)** is another way to make sure you use it before you lose it by transferring certain real estate into trust, as discussed below, and “freezing” the value from future estate taxation.

QPRT Overview

- Grantor creates QPRT, an irrevocable trust that allows grantor to live on the property for a term of years and designates beneficiaries, usually family members.
- Grantor contributes or gifts real property to the trust, creating a taxable lifetime gift.
- The property reverts to the remainder beneficiaries after the expiration of the QPRT term. However, the grantor may continue living in the house by leasing the property back from the remainder beneficiaries at fair market rent, which can further reduce the value of the grantor's taxable estate.

QPRT Advantages

- **Use of Gift Tax Exemption**. The amount gifted to beneficiaries in a QPRT falls under the grantor's lifetime federal gift tax exemption, helping to ensure that the current gift tax exemption amount does not go to waste.
- **Leveraged Gifting**. The value of the gift for tax purposes is the fair market value of the property minus the present value of the beneficiaries' right to receive the property at the end of the term of the QPRT. The "reduced" value of the gift allows the grantor to further leverage the current lifetime federal gift tax exemption by shifting wealth at a discounted valuation for tax purposes.
- **Tax Reduction**. The gift tax value is calculated at the time of the transfer, and all of the future appreciation will escape the grantor's taxable estate. In addition, a grantor can still claim real estate taxes and other associated deductions on their tax return.
- **Probate Avoidance**. Real property gifted to a QPRT is not subject to probate on the death of the grantor. A trustee or successor trustee has continuous and immediate access to the QPRT and can immediately transfer the subject property to the designated beneficiaries.
- **Multiple QPRTs**. Each individual may have up to two QPRTs at any one time, allowing a grantor to create a QPRT for a vacation home in addition to their primary residence.
- **Flexibility**. A grantor may sell real property that has been gifted to a QPRT without losing all of the tax benefits. To accomplish this, proceeds from the sale must be reinvested in a new real property that will now be subject to the original QPRT.

QPRT Disadvantage

- **Loss of Control**. QPRT planning requires the grantor to give up ownership of the residence following the QPRT term, meaning that the grantor must lease the property back from the remainder beneficiaries. Although these leases are often 99-year leases without rent, there is a psychological hurdle to overcome in "giving up" one's home and leasing it back from family.

As always, we value the confidence you have placed in MAI to be your trusted advisor. Setting up any trust requires an estate planning attorney licensed to practice in the state the trust is being created in. If you have any questions or would like to discuss any changes to your financial situation, please feel free to contact us at any time.