

PLANNING FOR THE FUTURE OF YOUR FARM

Legal tools and strategies for farm transition and estate planning

USING SPOUSAL LIFETIME ACCESS TRUSTS IN ESTATE PLANS

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On January 1, 2026, the federal estate tax exemption will significantly reduce unless Congress takes action to prevent the change. As this deadline nears, estate planning professionals are actively seeking strategies to help clients with high net worth minimize their potential estate taxes. One possible approach is using a Spousal Lifetime Access Trust (SLAT) in an estate plan.

A SLAT allows one spouse to transfer assets into a special type of trust and designate the other spouse as the trust's beneficiary. The beneficiary spouse receives distributions from the SLAT while living, primarily in the form of income. Upon the beneficiary spouse's death, the trust's assets are distributed to other trust beneficiaries tax-free. This strategy can reduce the taxable estate of the donor spouse.

As with any estate planning strategy, a SLAT has both advantages and disadvantages. This publication aims to explain how a SLAT works, its advantages and disadvantages, and situations in which a SLAT may be appropriate. Please note, this information is for educational purposes only and readers should consult with an attorney and tax advisor to determine the best strategy for individual circumstances.



WHAT IS A SLAT AND HOW DOES IT WORK?

A SLAT is an irrevocable trust designed as an estate planning tool. It provides spouses with income from assets while removing the assets from their estates.

The following example illustrates a SLAT.

Example 1. In 2024, Arthur establishes a SLAT with his wife Betty as the beneficiary. Arthur transfers farmland into the SLAT. As the farmland generates income, the income is distributed to Betty as the beneficiary. Betty deposits the income into Betty and Arthur's joint bank account. Arthur is able to use these funds as needed. Upon Betty's death, the trust assets transfer tax free to their heirs, who Arthur named as beneficiaries of the SLAT.

Here are the key components and characteristics of a SLAT:

Irrevocability. A SLAT is irrevocable, meaning that once it is established, it generally cannot be modified or revoked, and the assets transferred into the trust cannot be returned to the donor spouse. This feature is crucial for ensuring the assets are removed from the donor spouse's taxable estate.

Trustee management. The assets within a SLAT are managed by a trustee. The trustee can be the beneficiary spouse, another individual, or multiple people acting as co-trustees. The trustee's role is to manage and oversee the trust's assets, ensuring that they are used in accordance with the trust's terms and the best interests of the beneficiary spouse.

Beneficiary spouse. The beneficiary spouse is entitled to receive distributions from the SLAT during their lifetime. These distributions are typically in the form of income generated by the trust's assets. This setup provides the beneficiary spouse with financial support while keeping the principal of the trust intact and outside the donor spouse's taxable estate.

Distribution to beneficiaries. Upon the death of the beneficiary spouse, the assets remaining in the SLAT are distributed to the named beneficiaries. These distribution beneficiaries are often the couple's children but can be anyone other than the donor spouse. The assets are transferred to these beneficiaries free of estate taxes, offering a significant tax advantage.

IMPACT ON ESTATE TAXES

A Spousal Lifetime Access Trust (SLAT) can significantly reduce estate taxes through two primary mechanisms:

- 1. Exclusion from taxable estates.** When assets are transferred to a SLAT, their value is excluded from both the donor spouse's and the beneficiary spouse's taxable estates. This means that any future appreciation of the transferred assets is not subject to estate

taxes for either spouse. By removing these assets from their estates, couples can shield the growth of their wealth from potential estate tax liability.

- 2. Pre-exemption reduction transfers.** Large transfers made to a SLAT before the federal estate tax exemption is reduced can also provide significant tax advantages. If the value of the transferred assets exceeds the new, lower exemption amount set for 2026, the excess is not "clawed back" into the estate. This means that the amount exceeding the new exemption is not counted against the estate tax exemption or included in the taxable estate. This strategy is particularly effective for individuals with wealth exceeding the reduced 2026 estate tax exemption threshold.

CONSIDERATIONS FOR EFFECTIVE USE

It's important to understand that gifts exceeding the annual exclusion amount will reduce the donor's lifetime estate tax exemption. Simply transferring assets to a SLAT does not inherently reduce estate taxes. The effectiveness of this strategy hinges on two factors:

- 1. Appreciation of transferred assets.** The strategy is most beneficial when the transferred assets are expected to appreciate in value, as this growth will occur outside of the taxable estates.

Example 2. Arthur transfers a farm into the SLAT valued at \$1 million. Over the next 20 years, the farm increases in value to \$3 million. At Betty's death, the farm is distributed out to Arthur and Betty's two children.

Upon the transfer of the farm to the SLAT, Arthur's estate tax exemption was reduced by \$1 million. But, the additional \$2 million in appreciation was captured in the SLAT. Neither Arthur nor Betty's estate will include the \$2 million in appreciation.

- 2. Exceeding the exemption amount.** The strategy is particularly advantageous for those whose wealth surpasses the new estate tax exemption amount, as it allows for large transfers to be made without being subject to future estate taxes.

Example 3. Arthur transfers \$10 million of farmland into the SLAT in 2024. In 2026, the estate tax exemption is reduced to \$7 million. The \$3 million in excess of the new exemption amount is not "clawed back" into either Arthur or Betty's estate. Arthur and Betty were able to reduce their combined estates by \$3 million.

Note: Arthur's estate tax exemption will be \$0 at his death because it was reduced by the amount of the 2024 gift. Betty will have her full estate tax exemption at her death because she did not transfer assets.

ADVANTAGES AND DISADVANTAGES OF THE SLAT STRATEGY

There are three primary advantages to incorporating a SLAT strategy into an estate plan:

- 1. Exclusion from estate.** Assets transferred into a SLAT are not included in either spouse's estate. This is particularly beneficial for any appreciation in the value of the assets, ensuring that future growth is not subject to estate taxes.
- 2. Lifetime benefits.** The beneficiary spouse can receive income and, in some cases, principal from the trust, providing financial support during their lifetime through discretionary distributions approved by the trustee.
- 3. Asset protection.** Assets transferred to an irrevocable trust like a SLAT offer a level of protection from creditors of both spouses, helping safeguard the assets from potential claims.

There are also several disadvantages to using a SLAT strategy:

- 1. Irrevocable nature.** Once assets are transferred to a SLAT, the donor spouse cannot reclaim the assets. This permanent loss of control can be a significant drawback for some individuals who prefer flexibility in their estate planning.
- 2. Dependency on spousal relationship.** The effectiveness of a SLAT is closely tied to the stability of the marriage. Changes in marital status, such as divorce or the death of a spouse, can impact the donor spouse's ability to benefit indirectly from the trust income.

Example 4. Betty predeceases Arthur. Because the primary beneficiary of the SLAT has died, the income and assets are now distributed to the contingent beneficiaries. Arthur and Betty's children are the contingent beneficiaries. So, the income is paid to the children. Arthur has lost the indirect benefit from the income.

- 3. No step-up in basis.** Heirs do not receive a step-up in tax basis upon inheriting assets from a SLAT. This means that upon the sale of the assets, the beneficiaries may incur significant capital gains taxes. In contrast, assets inherited directly from an individual or through a revocable trust receive a stepped-up tax basis to the fair market value at the time of the original owner's death, potentially reducing capital gains tax liability.

Example 5. Arthur transferred a farm into the SLAT he inherited from his parents. The tax basis was \$1,000/acre when he inherited the farm. When Arthur's children inherit the farm, they will receive the same tax basis and will not receive a stepped-up tax basis. If the children sell the farm for \$10,000/acre, they will incur taxes on the \$9,000/acre gain.

EFFECT OF THE RECIPROCAL TRUST DOCTRINE

Establishing a SLAT for each spouse can maximize potential estate tax savings. However, if the two SLATs are too similar, the Internal Revenue Service may apply the “reciprocal trust doctrine” and include all the property in the spouses' estates. To avoid this outcome, the trusts must be significantly different from each other. If each spouse is establishing a SLAT, it is important to avoid the reciprocal trust doctrine. Differences can be achieved by:

- Executing the trusts at different times.
- Appointing different trustees or beneficiaries.
- Stipulating different distribution timelines for the assets.

SUMMARY

The Spousal Lifetime Access Trust (SLAT) is a valuable estate planning tool that can help reduce estate taxes, especially in anticipation of the potential reduction in the federal estate tax exemption in 2026. While a SLAT is not suitable for everyone, it can be extremely effective in specific situations, particularly for individuals with highly appreciating assets or those who can gift assets near the current federal estate tax exemption limit.

Implementing a SLAT requires careful planning and close collaboration with legal and tax advisors. As with any complex estate planning strategy, it is crucial to consult with an attorney and accountant experienced in estate tax issues to ensure a SLAT complies with all relevant laws and regulations and aligns with estate planning goals.

Find all our **Planning for the Future of Your Farm** resources at <https://go.osu.edu/farmplanning>

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