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The Washington Report
Wealth Transfer Edition

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From the Desk of an Estate Planning Attorney: Using SLATs, GRATS, and Sales to Grantor Trusts Post-OBBBA

KEY TAKE AWAYS:

- The One Big Beautiful Bill Act ("**OBBBA**") has created a sense of certainty about the application of transfer tax laws and minimized much of the planning urgency that was associated with the expected "sunset" of various transfer tax provisions. We are finding that this perceived stability under OBBBA is motivating clients at a variety of net worth levels to seek out lifetime estate planning opportunities as numerous issues other than federal estate tax remain, including federal and state income taxes, state estate taxes, and various non-tax objectives such as creditor protection and financial/asset management for younger family members.

- OBBBA's retention of the higher federal gift and estate tax exemptions enhances the need to evaluate the overall tax benefits of lifetime transfers versus the basis adjustment (often a basis step-up) that inherited assets typically receive when included in the decedent's estate. Accordingly, jurisdictional considerations continue to factor prominently into planning discussions, not only to determine a client's potential estate and income tax exposure at the federal and/or state level, but also to address the later income and capital gain taxation that the trusts and client's beneficiaries may face after the client's passing.

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- Implementing a traditional irrevocable trust, like a spousal lifetime access trust (**SLATs**), which incorporates maximum flexibility while enhancing the client's potential accessibility to the transferred assets, will create a solid planning foundation for most clients, which can then easily pivot to address desirable income tax planning, state tax planning and/or estate tax planning concerns, as needed based on existing or future tax laws.

- Clients with estates well above OBBBA's higher exemption thresholds (e.g., $75-$100 million+) should take advantage of the relative stability to fully use their available exemptions and front-load plans now. Installment sales to grantor trusts (especially when combined with a dynasty trust structure) and grantor retained annuity trusts (**GRATs**) remain appealing for these clients, particularly if they have already used most of their federal gift and GST tax exemptions.

- Note that we also are seeing much more interest in using non-grantor trusts for a variety of income tax planning purposes, particularly planning with qualified small business stock (**QSBS**) under Internal Revenue Code §1202. The favorable expansion of the QSBS gain exclusion under OBBBA, combined with the higher gift and GST tax exemptions, may provide additional opportunities for using non-grantor trusts, which may be eligible to take their own, separate (and additional) exclusion on the sale of the QSBS (so-called "stacking"). This and other non-grantor trust opportunities will be discussed in an upcoming Washington Report.

THE NEW "PERMANENCY" OF FEDERAL TRANSFER TAX LAWS

OBBBA increases the gift, estate and GST tax exemption to $15 million per person in 2026 (as inflation-indexed thereafter) and maintains the maximum 40% gift, estate, and GST tax rate. When combined with estate tax exemption portability between spouses, OBBBA will effectively shield married couples with estates of up to $30 million from federal estate tax as of 2026. In addition, since OBBBA does not have a built-in "sunset," most of OBBBA's changes, including its transfer tax changes, are "permanent." Of course, "permanency" is a relative term when it comes to tax legislation, and OBBBA's transfer tax changes could be reversed by a future Congress and administration. Careful consideration of these risks is still an important discussion item.

MORE CERTAINTY = MORE LIFETIME PLANNING

The relative certainty brought by OBBBA's enactment is motivating individuals who were locked in "wait and see mode" pending resolution of the tax debate. Based on inquiries we're receiving, existing and potential clients at a variety of net worth levels are interested in what types of lifetime planning may work for their overall estate plan under the new tax laws.
For families who expect to have estates that significantly *exceed* the higher federal estate tax exemption thresholds (e.g., married couples with $50 million+), lifetime planning to minimize estate tax exposure should continue to guide their decision-making. These clients may want to take advantage of the current legislative stability to front-load large-scale, multi-year wealth

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transfer plans, including gifts to dynasty trusts, zeroed-out GRATs, and sales to grantor trusts.[i] We also continue to recommend SLATs and other irrevocable grantor trust planning to clients *below* the current federal estate tax exemption levels, depending on their overall wealth, asset composition, and family circumstances, but with greater attention to the following considerations.

FOCUSING BEYOND FEDERAL ESTATE TAXES

Income Taxes. OBBBA's transfer tax changes increase the importance of evaluating the long-term income tax consequences of lifetime planning, since lifetime gifts and sales to grant or trust generally result in the recipient taking a "carry-over" income tax basis in the gifted or transferred asset. The potential income tax liability to the recipient upon a later taxable disposition of the transferred asset could be significant, especially if that asset has a low tax basis and/or substantial potential for growth. On the other hand, the large, permanent federal estate tax exemption under OBBBA allows clients to shelter more property from federal estate taxes and receive the benefit of a basis adjustment/step-up at death. This benefit is magnified for residents of states that impose income taxes but not estate taxes.

For instance, California does not impose a state estate tax, so its residents may only face the 40% federal estate tax. But California residents are subject to a top long-term capital gains (**LTCG**) rate of 13.3% at the state level, plus a 20% top federal LTCG rate and a 3.8% net investment income (**NII**) tax. In cases like this, the analysis of whether clients should make lifetime gifts will depend greatly on the difference between the projected income taxes due on the gain realized from the sale of gifted property as compared to the estate tax exposure applicable to inherited property, factoring in both federal and state tax rates. *If the difference between the projected total income taxes and estate taxes is small, lifetime transfers may not generate sufficient tax savings to justify the transfer or, at a minimum, will require a careful evaluation of the trade-offs)*. Additional planning may be implemented to both minimize estate tax exposure and achieve a basis step-up, but with added costs and complexity.

State Estate Taxes. Clients falling under the federal estate tax exemption may still face estate taxes if they live in a state with a state estate tax. Sixteen states and the District of Columbia still impose an estate and/or inheritance tax.[ii] Since the estate tax exemptions in most of these states are far below the federal exemption and are not portable between spouses (except in Maryland and Hawaii),[iii] clients living in these states will want to consider their potential exposure and planning options for mitigation.

Non-Tax Considerations. Irrevocable trusts like SLATs continue to address numerous practical client concerns, including providing confidentiality and creditor protection for trust beneficiaries, providing a vehicle for centralized wealth management and/or succession planning and family governance for shared assets (like a business or real estate), and controlling the flow of information and assets to younger beneficiaries while teaching them financial responsibility, perhaps with oversight from other family or professional wealth managers/trustees.

SLATs

Generally, a SLAT is an irrevocable grantor trust created by one grantor for the benefit of the

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grantor's spouse[iv] and, often, the grantor's descendants.

Why We're Using:

- **Foundation, Multi-Purpose Structure**. SLATs have long served as the workhorse of lifetime estate planning. They typically form the "foundational" trust structure for irrevocable life insurance trusts (**ILITs**), dynasty trusts, and sales to grantor trust. Their built-in flexibility (as discussed below) also allows clients to implement desired non-tax planning while setting up a base from which to deploy more sophisticated planning if or when the clients experience a significant increase in wealth and/or tax laws change.

- **Access.** So long as the grantor and the beneficiary-spouse remain married, SLATs allow for indirect access to the trust assets, and the beneficiary-spouse, if acting as a trustee or given a lifetime limited power of appointment under the trust, can make distributions made pursuant to an ascertainable standard (like for health, education, maintenance, and support).

- **Flexibility**. For income tax purposes, SLATs generally default to grantor trust status due to the spouse's beneficial interest,[v] which provides maximum flexibility for the grantor to engage in non-recognition transactions with the trust, including through loans (like split-dollar loans) and sales. When creating SLATs, we typically incorporate added flexibility into the agreement to allow the trust to adapt to changes in tax, financial for family circumstances, such as by:

    - Giving the client a substitution power over trust assets (which bolsters grantor trust treatment) and authorizing trust loans to the grantor without security (but with adequate interest).
    - Specifically authorizing the trust's purchase of life insurance, including financed purchases (such as split-dollar loans or third-party financing).
    - Giving an independent trust protector or trustee the discretion to (i) reimburse the grantor's income tax liability (ii) implement an "internal" decanting (so reliance on a state statute is not required, to the extent permitted by applicable law) (iii) change the trust's jurisdiction or governing law, (iv) modify the trust's tax status, including by toggling off grantor trust status or decanting to a non-grantor trust, and (v) grant, modify, or revoke testamentary limited or general powers of appointment (**GPOA**) for beneficiaries (particularly for both tax and non-tax objectives such as creditor protection, imminent divorce, substance abuse, etc.)

- **Basis Management Options.** To manage the income tax basis of the trust's assets, the grantor can exercise the substitution power to swap in high basis assets of an equivalent fair market value for low basis trust assets, without triggering an income or capital gains recognition event. Alternatively, an independent trust protector or trustee, if it has the power, can grant the beneficiary-spouse a GPOA over the trust assets, so that there will be a basis step up due to the inclusion of the trust assets in the beneficiary-spouse's estate at death.

- **State Estate Tax Planning.** A lifetime gift to a SLAT can result in reduced state estate tax exposure in states that impose an estate tax but do not levy a gift tax.[vi] To illustrate with a simplified example, assume Jack and Jill are residents of State Y, which has a top state estate tax of 16% and a portable exemption of $5 million. Their combined estate, which they leave to each other, is valued at $20 million.Upon the death of the survivor in 2026 (assume they die in the same year, with Jack predeceasing Jill), State Y assesses an estate tax of $1,600,000 (($20 million - $10 million of state exemption) x 16%). If, instead, Jack had

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created a SLAT benefiting Jill and funded it with $5 million, their combined estate would be reduced to $15,000,000, resulting in a state estate tax liability of $800,000 (($15 million - $10 million) x 16%), thereby saving $800,000 (16% of $5 million).

- **Life Insurance.** SLATs often serve as ILITs to acquire life insurance on the grantor's life. As a grantor trust, the SLAT's income is taxable personally to the grantor; however, this liability can be mitigated when the SLAT holds life insurance, since growth within the policy during the grantor's life (as the insured) and the payment of policy death benefits at the grantor's death generally are not subject to income or capital gains tax. Further, the trustee, as policy owner, may be able to access cash value up to the owner's basis in the policy (i.e., investment in the contract basis) without current income tax.[vii]

  Accordingly, with the right design, life insurance products can supplement lifetime retirement planning by providing for tax-efficient cash value accumulation and access while also supporting estate planning by hedging against the insured's untimely death. When life insurance is held in a SLAT, the trust can access these benefits by taking income tax-free policy

  withdrawals or loans that it can then use to support distributions to the beneficiary-spouse during the grantor's life. After the grantor's death, the SLAT ensures that the policy death benefits are preserved and managed for the SLAT beneficiaries, while protecting them from creditors or potential estate tax exposure, depending on then applicable laws. If GST exemption is allocated to the SLAT, that protection can persist for multiple generations.

  The larger federal gift and GST tax exemptions also makes it easier to fund lump-sum gifts into a SLAT. The trust can then use these assets over time to pay policy premiums, thereby avoiding the administrative hassles and limitations of relying on annual exclusion gifts, or to create a side investment fund that can eventually be used to exit a split-dollar premium funding strategy.

When We're Using:

We are using SLATs for clients below the $30 million net worth threshold and for clients with wealth exceeding that amount but who have concerns about parting with access and/or control. While clients with more significant wealth certainly can use SLATs, they generally do not have the same concerns about preservation of access to the trust funds and can focus more on creating multi-generational dynasty trusts for descendants.

But Watch For:

- **Basis Monitoring**. It will be important to monitor the basis of trust assets to decide when the grantor should substitute in high basis assets or an independent trustee or trust protector should grant a GPOA to the beneficiary-spouse.

- **Fiduciary Duties**. Trustees, including independent trustees, have a fiduciary duty to act in the best interest of the trust beneficiaries, which may run counter to certain actions, such as toggling off grantor trust status (which shifts the income tax liability to the trust rather than the grantor). Ideally, these types of powers will be exercised at the discretion of a designated independent person acting in a non-fiduciary capacity.

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- **Termination of Grantor Trust Status**. Terminating grantor trust status during the grantor's life continues to require careful planning, as the spouse can no longer be a current or future beneficiary of the trust. Also, the trust assets will need to be analyzed, as income taxation may be triggered upon termination if the trust owes liabilities in excess of basis. In addition, if the trust owns any S corporation shares, termination of grantor trust status could make the trust an ineligible shareholder unless a qualified subchapter S trust (**QSST**) or electing small business trust (**ESBT**) election is made.

- **Income Taxation after Termination of Grantor Trust Status**. Termination of grantor trust status will result in the trust bearing its own federal and state income tax liability. Taxation of non-grantor trusts by states varies significantly and may depend on a variety of factors, including the grantor's residence when the trust was created, on the residence of the trust beneficiaries, on the residence of the trustee or other trust fiduciaries/advisors (like investment advisors of directed trusts) and/or the location of trust assets. The SLAT's jurisdiction should be carefully selected from the outset, after reviewing these considerations.

- **Reciprocal Trusts**. While some spouses may want to implement SLATs to benefit each other, they must proceed carefully to avoid running afoul of the reciprocal trust doctrine, particularly if estate tax exposure is a concern. This doctrine can result in estate tax inclusion of the trust assets if the interrelated trusts are considered to have substantially identical terms and are part of the same transaction or plan.

- **Beneficiary-Spouse Death or Divorce**. The grantor will no longer indirectly benefit from the beneficiary-spouse's interest in the SLAT if the beneficiary-spouse predeceases the grantor or they divorce. Further, a divorce does not automatically terminate a SLAT's grantor trust status, leaving the grantor liable for the income tax liability of a trust that benefits an ex-spouse. SLAT planning should include contingences for what happens in these cases.[viii]

SALES TO GRANTOR TRUSTS

An installment sale to a grantor trust is an "estate freeze" in which the grantor sells assets to a grantor trust at fair market value for an installment note bearing interest at a minimum rate (no lower than the applicable federal rate to avoid potential gift taxes). The sale is disregarded for income tax purposes, so it does not generate recognizable income or capital gain to the seller. Asset growth in excess of the note's interest rate is transferred out of the grantor's estate without using added gift or GST tax exemption. If the purchasing trust is newly created, however, it is typically capitalized with a "seed" gift to evidence its ability to repay the note, which often uses an equivalent amount of gift and GST tax exemption.

Why We're Using:

- **No Changes under OBBBA**. As OBBBA did not affect the tax treatment of irrevocable grantor trusts, sales to grantor trusts remain a viable lifetime planning method.
- **Larger Sale Transactions**. Higher exemptions allow larger initial gifts to the grantor trust, which in turn can seed the trust to support larger sales (or the payment of life insurance premiums to secure the note repayment obligations).
- **Declining Rates**. The relatively low-rate environment (with more rate cuts expected)

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increases the potential for asset appreciation in excess of the interest rate charged on the note (the so-called "hurdle rate").

- **Dynasty Trust Planning**. Assets transferred to a GST exempt trust via a sale do not require the additional allocation of GST exemption to cover the transfer. Accordingly, larger installment sales to grantor trust can better leverage the GST exemption used to initially fund the trust and may result in an overall wealth transfer that significantly exceeds the GST exemption originally allocated.
- **Grantor Trust Benefits**. This technique also benefits from the flexibility and other features associated with grantor trusts discussed above.

When We're Using:

We are using installment sales to grantor trusts for higher net worth families who still need additional estate tax planning and/or have already used most of their federal gift and estate tax exemptions. Alternatively, we are also working with clients that have existing transactions to see if it makes sense to use their higher gift and GST exemptions to prepay existing installment notes, so we can close out the client's prior wealth transfer and streamline their estate and trust planning going forward.

But Watch For:

- **Death with an Outstanding Note**. If the client dies while the installment note is outstanding, the value of the note will be included in the client's estate. There also could be potential income tax issues and/or gain recognition from the sale (including potential treatment of the gain/income as income in respect of a decedent when the note is paid).
- **Lifetime Termination of Grantor Trust Status with an Outstanding Note**. If there is a desire to toggle off grantor trust status during the grantor's life, the note should be repaid prior to termination to avoid potential gain recognition on the transaction.
- **Basis Monitoring**. As with a gift to a SLAT, assets sold to the grantor trust will take a carry-over basis, so monitoring and management of the trust's income tax basis in its assets is required and should be addressed as needed, including through the exercise of the grantor's substitution power or the granting of GPOAs to beneficiaries.

GRATs

Like sales to grantor trusts, GRATs are an "estate freeze" in which a grantor transfers assets to a trust, retaining the right to an annual annuity payment for a specified term. Typically, the annuity is expressed as a fixed percentage of the trust's initial value (which percentage may be structured to increase by up to 120% annually) and calculated based on the 7520 rate for the month of the GRAT's creation.

At the end of the GRAT term, any remaining trust assets pass to the grantor's designated beneficiaries without estate tax, but only if the grantor survives the term.

Why We're Using:

- **No Gift Required**. GRATs generally are created to greatly minimize or "zero-out" the gift tax value of the interest passing to the remainder beneficiaries at the end of the term, so little or

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no federal gift tax exemption is needed to fund the trust. This can allow a client to engage in wealth transfer planning even if they have limited gift tax exemption remaining or preserve unused federal estate exemption to obtain a basis step up for other assets that may be included in the client's taxable estate.

- **Codified Approach**. Like sales to grantor trusts, zeroed-out GRATs transfer asset appreciation above a specified hurdle rate (7520 rate) out of the estate, but they also benefit from clearer guidance with respect to their implementation and taxation, since they are codified under Internal Revenue Code §2702.
- **Declining Rates**. Also like sales to grantor trusts, GRATs benefit from lower interest rates, so the potential for further rate cuts may create an even more favorable environment for GRATs.
- ***Substitution Flexibility***. As a grantor trust, the grantor of a GRAT can hold a substitution power over the GRAT assets, which he or she can use to swap out assets of an underperforming GRAT or to lock in the gains of a successful GRAT.

When We're Using

As with sales to grantor trusts, we are using GRATs for higher net worth families who still need to reduce their estate tax exposure and/or who have already used most of their federal gift tax exemptions. GRATs do not require any form of seed gift to implement and may be particularly suitable for making leveraged wealth transfers for the benefit of children.

But Watch For:

- **Not GST Tax Efficient**. GRATs generally are not as efficient for GST tax planning since GST exemption cannot be allocated until the end of the GRAT term. They require additional planning to address the potential GST tax exposure for the remainder trust assets.
- **Estate Inclusion**. The GRAT will be includible in the grantor's estate if he or she does not survive the initial GRAT term.
- **Funding and Monitoring**. While almost all lifetime transfer planning requires some monitoring, GRATs are particularly sensitive to investment performance, so asset selection and regular investment performance reviews will be key to a GRAT's success

KEY TAKE-AWAYS:

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- Implementing a traditional irrevocable trust, like a spousal lifetime access trust (**SLATs**), which incorporates maximum flexibility while enhancing the client's potential accessibility to the transferred assets, will create a solid planning foundation for most clients, which can then easily pivot to address desirable income tax planning, state tax planning and/or estate tax planning concerns, as needed based on existing or future tax laws.

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- Note that we also are seeing much more interest in using non-grantor trusts for a variety of income tax planning purposes, particularly planning with qualified small business stock (**QSBS**) under Internal Revenue Code §1202. The favorable expansion of the QSBS gain exclusion under OBBBA, combined with the higher gift and GST tax exemptions, may provide additional opportunities for using non-grantor trusts, which may be eligible to take their own, separate (and additional) exclusion on the sale of the QSBS (so-called "stacking"). This and other non-grantor trust opportunities will be discussed in an upcoming Washington Report.

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[i]While beyond the scope of this Wahington Report, other sophisticated planning techniques will remain relevant for these ultra-high networth clients, such as charitable split interest planning and private placement life insurance.

[ii] Connecticut, Hawaii, Illinois, Maine, Maryland, Massachusetts, Minnesota, New York, Oregon, Rhode Island, Vermont, Washington and the District of Columbia impose a state estate tax. Kentucky, Maryland, Nebraska, New Jersey, Pennsylvania have an inheritance tax.

[iii] To illustrate a few examples, D.C.'s exemption in 2025 is $4,873,200, inflation-indexed annually, but without portability between spouses. Maryland's estate tax exemption is fixed at $5 million (i.e., no inflation adjustments) but is portable between spouses. Massachusetts' estate tax exemption is fixed at $2 million, with no portability. New York's estate tax exemption is $7.16 million in 2025 and is not portable. Further,if the New York taxable estate value exceeds $7.518 million in 2025 (105% of the exemption amount), New York estate tax applies to the value of the entire estate, not just the portion exceeding the exemption (the estate tax "cliff"). Certain gifts made within three years of death also may be added back in to the value of the New York taxable estate.

[iv] References to "spouse" herein also include a domestic partner.

[v] While outside the scope of this article, it is possible to create a SLAT as a non-grantor trust (a so-called "spousal lifetime access nongrantor trust" or "SLANT"), but the trust agreement requires careful drafting, including provisions requiring the consent of an "adverse party" (as determined under Internal Revenue Code §672) to consent to any distributions made to the spouse, among other restrictions.

[vi] Connecticut is currently the only state that imposes a state-level gift tax.

[vii] Assuming the policy is not a modified endowment contract (**MEC**).

[viii] Contingency planning could include giving the beneficiary-spouse or an independent party a limited power to appoint trust assets to the grantor (with careful structuring based on the applicable laws of the trust's jurisdiction to avoid creating access for the grantor's creditors and/or pulling the assets back into the grantor's estate). To protect against divorce, the SLAT could define "spouse" based on the person then married to the grantor rather than naming the current spouse. It also could incorporate provisions to effectuate a termination of grantor trust status so that the grantor does not remain liable for the trust's income tax liability post-divorce.

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