Steve Leimberg's Estate Planning Email Newsletter - Archive Message #3071

Date: 02-Oct-23
From: Steve Leimberg's Estate Planning Newsletter
Subject: Andrew J. Krause, David A. Ruben and J.P. Bratcher: Tax Planning for 2026 - Are Your Married Clients Being Properly Advised on the Risk of Divorce?

"Half of all marriages end in divorce - and then there are the really unhappy ones." -Joan Rivers

Andrew J. Krause, **David A. Ruben** and **J.P. Bratcher** provide members with important and timely commentary that examines an often-overlooked question: what happens if one of your clients who has created a SLAT gets divorced?

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David A. Ruben is a shareholder in the Naples, Fla. office of GrayRobinson. He focuses his practice on estate planning, estate and trust administration, and tax and wealth transfer planning. David has authored or co-authored over a dozen articles on various estate planning issues, as well as a book on intentionally defective grantor trusts.

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Here is their commentary:

EXECUTIVE SUMMARY:

You're a diligent estate planning attorney and take pride in making sure your clients have the appropriate tax planning in place. Recently, this has taken the form of preparing for the sunset of the historically-high lifetime estate and gift tax exemption scheduled to occur on January 1, 2026 (the "Sunset").[i]

You've broached this topic early so your high-net-worth clients aren't scrambling at the end of 2025. As for your high-net-worth married clients, many have already created one or more Spousal Lifetime Access Trusts ("SLATs") and many more will do so in the next two years.[ii] 2025 comes and goes and Congress fails to pass any legislation to prevent the Sunset. Many high-net-worth married couples who had a big estate tax issue to worry about in 2025 now have a much bigger estate tax issue to worry about - *but not your high-net-worth married clients*! Because of your attentiveness the vast majority of your clients listened to your advice.

Nice work! You've just saved these clients and their families millions of dollars in transfer taxes. But what will happen if one of your clients who has created a SLAT gets divorced? If this is something you haven't spent a lot of time thinking about (and you are not alone), read on . . .

COMMENT:

OVERVIEW OF FLORIDA LAW REGARDING THE DIVISION OF ASSETS UPON DIVORCE

Statutory Goal: Equitable Division

Florida has set forth a statutory scheme in F.S. §61.075 to guide courts in the division of assets and liabilities upon divorce. Generally, the statute operates by specifying which assets and liabilities are classified as marital versus nonmarital, and directs courts to start with the premise that marital assets and liabilities should be divided equally unless there is justification to do otherwise.[iii]

Under F.S. §61.075(6)(a)(1), "marital assets" are defined as:

- assets acquired during the marriage by either or both spouses;[iv]
- the enhancement in value of nonmarital assets from the efforts of either party during the marriage or from a contribution to or expenditure thereon of marital funds;[v]
- gifts from one spouse to the other during the marriage;[vi] and
- all benefits, rights and funds accrued during the marriage in retirement, pension, profit-sharing, annuity, deferred compensation, and insurance plans and programs.[vii]

Additionally, the statute creates a rebuttable presumption that all assets acquired during the marriage are marital assets if not specifically established as nonmarital assets.[viii]

Under F.S. §61.075(6)(b), "nonmarital assets" are defined as:

- assets acquired by either party prior to marriage (and assets acquired in exchange for such assets);[ix]
- assets acquired separately by either party by noninterspousal gift, bequest, devise, or descent (and assets acquired in exchange for such assets);[x]
- all income derived from nonmarital assets during the marriage unless the income was treated, used, or relied upon by the parties as a marital asset;[xi] and
- assets excluded from marital assets by valid written agreement of the parties (and assets acquired in exchange for such assets).[xii]

What Effect Does Divorce Have on a SLAT?

So what effect will divorce have on a SLAT? If a SLAT has been created for both spouses (of course on a non-reciprocal basis), Florida law can result in unwanted and unexpected results. If a SLAT has been created for only one spouse, Florida law can be downright brutal (certainly from the perspective of the settlor spouse).

For years, the Florida statutes have included safeguards for many estate planning documents that in general treat an ex-spouse as pre-deceased upon divorce. This is the case for wills,[xiii] powers of attorney,[xiv] heath care advanced directives[xv] and *revocable* trusts.[xvi] However, there is no such corresponding provision for *irrevocable* trusts (and a SLAT by definition is irrevocable). As such, Florida courts that have analyzed the effect of divorce on an irrevocable trust have generally relied on the four corners of an unambiguous trust agreement to discern the settlor's intent from the plain meaning of the terms used therein.[xvii] In other words, if a SLAT does not contain provisions to alter its terms upon divorce, the settlor can be stuck with an irrevocable trust for the benefit of an ex-spouse under which that ex-spouse may be the sole trustee.

As to how SLAT assets are classified for the purposes of equitable distribution upon divorce, Florida courts have held that such assets are nonmarital assets, reasoning that: (i) an irrevocable trust is "an entity distinct from the Former Husband and the Former Wife"[xviii] and (ii) as such, the assets owned by the irrevocable trust are "[a]kin to assets owned by a corporation, limited liability company, or partnership . . . [which is] ordinarily third-party property which **cannot be divided upon divorce**."[xix] In Nelson v. Nelson, the court found this to be the case *notwithstanding* the fact that under the terms of the SLAT before the court (which was created by the ex-husband), the ex-wife was both the trustee and beneficiary.[xx] In determining which assets are marital vs.

nonmarital, courts have also looked to whether this is addressed in the plain language of a nuptial agreement.[xxi]

HOW TO ADDRESS THE RISK OF DIVORCE FOR CLIENTS CREATING SLATS

An estate planning attorney counseling a client with regard to the creation of a SLAT should consider a number of steps to address the risk of divorce to protect both the client and the drafting attorney.

Put it in Writing

As a practical matter, it is prudent for any estate planning attorney counseling a client regarding the creation of a SLAT to:

1. broach the topic of divorce;
2. explain the implications and risks;
3. present the client with various options to address the issue (see below);
4. document the client's wishes in this regard; and
5. perhaps most importantly, do all of the above in writing (e.g., discuss the issue with the client by email or give the client a memorandum explaining the issue and have the client sign a document acknowledging receipt).

Many of us represent clients who have been married for fifty years or more, might chuckle at the prospect of divorce (most of us have heard a client say "that would never happen!"), and may very well decline any and all recommended remedial measure to address the risk of divorce with regard to a SLAT. However, if this same dismissive client creates a SLAT and later gets divorced, you will be thankful you have clear documentation in your records of the discussion described in this paragraph.

Include Remedial Provisions in the SLAT

One remedial measure is to include language in the trust agreement to "take out" the beneficiary spouse in the event of divorce. For example, the trust agreement could list "my spouse" as one of the permissible beneficiaries, but define "my spouse" as the individual to whom the settlor is then-married at any point in time. Alternatively, the trust agreement could include a clause that treats the beneficiary spouse as having pre-deceased the settlor for all purposes in the event of divorce (or perhaps in the event either spouse files for divorce). In the event of divorce, both clauses remove an ex-spouse as a SLAT beneficiary, and the latter also removes an ex-spouse as the SLAT trustee.

In some instances, such as when the client relies on a postnuptial agreement, the ex-spouse may remain as a SLAT beneficiary post-divorce. One issue to consider here are the income tax implications for the settlor spouse. SLATs are often structured to be grantor trusts, resulting in the settlor being treated as "owner" of the trust assets for income tax purposes.[xxii] However, a SLAT settlor may not want to pay the income taxes for the trust post-divorce. As such, it is prudent to include some mechanism in the SLAT to allow for a change in the grantor trust status as needed.

Postnuptial Agreement

The above remedial measures may in some cases be sufficient, and in some cases may be the client's preference, to address the risk of divorce in a SLAT. Another option is to have the clients sign a postnuptial agreement in which the spouses agree as to the treatment of the SLAT assets in the event of divorce.

While a full-blown postnuptial agreement would be effective for this purpose and is worth suggesting, as a practical matter it might not be realistic to expect every client considering a SLAT to do this. A more palatable alternative for many clients is a postnuptial agreement limited in scope to addressing the treatment of the SLAT assets in the event of divorce.

In either version, the parties could agree, for example, that in the event of divorce the then-current fair market value of SLAT assets: (i) shall be treated as a marital asset for the purpose of equitable division; and (ii) will be treated as an allocation and offset against the share created for the SLAT beneficiary-spouse. This language may be appropriate where a SLAT names the spouse as both the sole beneficiary and sole trustee.

Conclusion

Estate planning attorneys simply cannot ignore the likelihood, risk and implications of divorce when counseling clients regarding the creation of a SLAT.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Andrew J. Krause
David A. Ruben
J.P. Bratcher

CITE AS:

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CITATIONS:

[i] The Tax Cuts and Jobs Act passed in 2017 provided for a basic exclusion amount ("BAE") for each individual of $10,000,000, which is then adjusted annually for inflation (retroactively to 2010). This essentially doubled the then-current BAE. However, the act included a sunset provision providing that on January 1, 2026 the BAE will revert to pre-Tax Cuts and Jobs Act amounts (essentially, cutting the BAE in half). This sunset will occur unless Congress passes legislation to extend or otherwise revise the BAE.

[ii] There are a variety of tax planning techniques commonly used by estate planning attorneys to help clients plan for the Sunset including transfers to irrevocable trusts for children, annual exclusion gifting and transfer to SLATs. This article will focus on the latter, which at least for married clients will likely be the most commonly-used tax planning technique to address the Sunset. While a detailed dive into SLATs is beyond the scope of this article, a SLAT is simply an inter-vivos irrevocable trust created by a married individual for the benefit of his spouse (and sometimes descendants). A common goal of a SLAT is for the settlor spouse to: (i) fully use some or all of his or her remaining lifetime exemption (often with the goal of using such exemption if there is a risk that it may be taken away); (ii) insure that the trust assets (including future appreciation) are not subject to transfer taxes; (iii) retain certain types of indirect access to trust assets; and (iv) in many cases, take advantages of discounted values when funding this type of trust.

[iii] F.S. §61.075(1).

[iv] F.S. §61.075(6)(a)(1)(a).

[v] F.S. §61.075(6)(a)(1)(b).

[vi] F.S. §61.075(6)(a)(1)(d).

[vii] F.S. §61.075(6)(a)(1)(e).

[viii] F.S. §61.075(8).

[ix] F.S. §61.075(6)(b)(1).

[x] F.S. §61.075(6)(b)(2).

[xi] F.S. §61.075(6)(b)(3).

[xii] F.S. §61.075(6)(b)(4).

[xiii] F.S. §732.507(2).

[xiv] F.S. §709.2109(2)(b).

[xv] F.S. §765.104(2).

[xvi] F.S. §736.1105(2).

[xvii] See Nelson v. Nelson, 206 So. 3d 818, 819 (Fla. 2d DCA 2016), Hansen v. Boethe, 10 So. 3d 213, 214 (Fla. 2d DCA 2009).

[xviii] Nelson v. Nelson, 206 So. 3d 818, 820 (Fla. 2d DCA 2016).

[xix] Id. at 822 (emphasis added), citing Brett R. Turn, Equitable Distribution of Property § 6:94 (3d ed. 2005).

[xx] Nelson at 820.

[xxi] See Hahamovitch v. Hahamovitch, 174 So. 3d 983, 986-87 (Fla. 2015).

[xxii] IRC § 671. A trust is a grantor trust if the terms of such trust trigger one of the rules contained in IRC §§ 673 – 679.

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