ESTATE PLANNING INSIGHTS

ESTATE PLANNING NEWSLETTER

UNDERSTANDING THE RECIPROCAL TRUST DOCTRINE AND ITS IMPACT ON ESTATE AND GIFT TAXATION

Estate Planning Considerations for High Net-Worth Individuals

High Net-Worth Individuals ("**HNWI**") will typically have sophisticated estate plans given the size of their estate and uniqueness of their assets. The 2025 gift and estate tax exemption is $13.99 million or $27.98 million between married spouses. However, the gift and estate tax exemption will be reduced in half in 2026, so many HNWIs are looking to maximize the use of the heightened gift and estate tax exemption levels prior to the end of 2025.

Understanding the Reciprocal Trust Doctrine

The reciprocal trust doctrine is a judicially created doctrine developed in response to perceived abusive tax avoidance where two parties, typically spouses, create trusts for each other. This allows each lifetime enjoyment over their property while avoiding the property being included in their gross estate. Under the reciprocal trust doctrine, the beneficiary of the trust at issue is deemed to be the transferor of the funds into the trust, thereby causing inclusion of the funds in their gross estate.

Example of the Reciprocal Trust Doctrine in Action

For example, if spouses were each to create and fund an identical trust for each other, the reciprocal trust doctrine could apply so that each spouse would be the grantor and beneficiary of the trust they created, thereby causing estate tax inclusion.

Importance of Avoiding the Reciprocal Trust Doctrine

Avoiding the reciprocal trust doctrine is incredibly important for HNWIs in today's tax planning environment. Many HNWIs are interested in transferring large amounts of wealth out of their estate for federal gift and estate tax purposes while still retaining some access to the gifted funds.

Spousal Lifetime Access Trusts (SLATs) as a Planning Tool

A common planning option that accomplishes this goal is gifting assets to a spousal lifetime access trust ("**SLAT**") for the benefit of the grantor's spouse and descendants. The spouse can receive distributions from the SLAT, which then can be used for the benefit of the marital unit.

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It is common for HNWIs to establish a SLAT for the benefit of their spouse and descendants and for the other spouse to also create a SLAT for the benefit of their spouse and descendants. However, if there is not careful planning, such structuring will run afoul of the reciprocal trust doctrine and cause estate tax inclusion, thereby removing the benefits of the planning.

Strategies to Avoid the Reciprocal Trust Doctrine

A common way to avoid the reciprocal trust doctrine is to create differences between the SLATs drafted for each spouse. There are several ways to create differences between the SLATs to avoid the application of the reciprocal trust doctrine.

Use of Directed Trust Provisions

Variations in directed trusts can provide a unique opportunity to avoid the reciprocal trust doctrine. One spouse could create a SLAT in a jurisdiction that allows for directed trust provisions, and the other spouse can create a SLAT in a jurisdiction without directed trust provisions. Having this established, along with other precautionary differences between the SLATs, will avoid the application of the reciprocal trust doctrine.

Structuring Beneficiary Provisions Differently

Another way to avoid the reciprocal trust doctrine is that in one of the SLATs, the spouse will be a beneficiary, and in the other SLAT, the spouse will not be a beneficiary but can be later added as a beneficiary by the trust protector.

Conclusion

Given what is at stake for the HNWI and the pending significant reduction in the gift and estate tax exemption, it is imperative that the HNWI review their gift tax planning options. If they move forward with SLATs, they must ensure the SLATs are drafted to avoid the reciprocal trust doctrine and achieve the tax planning benefits that were intended.

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