

Life Insurance

As an Estate Planning Tool

A main purpose of estate planning is to provide the most for your beneficiaries at the least tax cost. Initially, this will involve preparing documents that take maximum advantage of the gift and estate tax exemption through a typical marital trust/credit shelter trust plan. As your estate grows, you may use more complicated planning, including qualified personal residence trusts (QPRTs), grantor retained annuity trusts (GRATs), irrevocable life insurance trusts (ILITs) and charitable remainder trusts (CRTs). Life insurance is a key ingredient in estate plans, including those plans that involve assets of \$10 million or more where substantial estate taxes will be owed.

Pay Estate Taxes

Life insurance lends itself to use as a gift. If you put the life insurance policy into an ILIT, funds you use to pay the relatively small annual premiums can be treated as gifts, provided you meet certain requirements.

These gifts are leveraged at death into substantial benefits passing to the next generation income and estate tax free. Additionally, proper planning can leverage the \$1.01 million generation-skipping transfer tax exemption to extraordinary levels.

If you die within three years of transferring an existing policy into the ILIT, however, the insurance proceeds will be includable in your estate for federal estate tax purposes. Thus your estate will have to pay estate taxes on the proceeds without actually receiving them. Consider purchasing an inexpensive term life insurance policy and retaining the policy for a three-year period to help pay the additional taxes if the gifted insurance ends up being included in your estate.

Another area where gifted assets could be included in your estate is in a QPRT or GRAT. If you establish a QPRT and die during its term, the value of the gifted residence will be brought back into your estate for federal estate tax purposes.

However, the residence itself may not be available to satisfy the tax that will result from the inclusion. The same result will occur if you establish a GRAT and die during its term.

When creating a QPRT or GRAT, consider buying an insurance policy to pay taxes in case the gifted assets are included in your estate. Purchase the insurance through an ILIT. The proceeds payable to the trust, while excluded from your estate for federal estate tax purposes, can provide the liquidity needed to pay your estate taxes. For example, the trust can make a loan to — or can purchase illiquid assets from — your estate, thereby providing the liquidity needed to pay estate taxes.

Replace Wealth

In addition to using insurance to pay estate taxes for a short term, you can use it as a wealth replacement tool. For example, if you wish to give significant assets to charity, you may choose to establish a CRT. By placing assets in a CRT, a significant charitable contribution can be made on your death, while providing you with an income tax deduction during your life. The value of the income tax deduction can be applied toward

purchasing life insurance. The insurance, purchased through an ILIT, will then provide assets for your family to replace those that ultimately will be distributed to charity.

Survivorship life insurance can generally be used as a wealth replacement vehicle, depending on certain factors. First, determine whether existing estate assets will generate sufficient cash flow to meet your spouse's income needs following your death. Second, determine whether your estate is also capable of paying life insurance premiums still due if you are the primary wage earner. Assuming that the answers to both questions are "yes," then the proceeds from a survivorship policy can replace the estate tax payable on your spouse's death.

Life Insurance Can Be Integral To Your Estate Plan

We have touched on only a few of the possible ways life insurance can become an integral part of any estate plan. We would be glad to assist you in determining how life insurance fits into your estate plan. Please call us to discuss your specific goals and situation.