INDIVIDUAL LIFE INSURANCE

A Consumer Resource

The Effective Use of Life Insurance in Wealth Transfer Planning

A Guide for Professionals and Consumers

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There are complex legal and tax implications associated with the various strategies discussed and clients are encouraged to consult their own tax and/or legal advisors to determine whether any strategy is appropriate for you.

Furthermore, this material is based on our understanding of current federal income, gift and estate tax laws as presently interpreted by the Internal Revenue Service (IRS). Any changes in such laws or interpretations could affect the result illustrated. In particular, under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), the federal estate and generation-skipping transfer (GST) taxes are scheduled to be repealed for taxable years ending (and in the case of the GST tax, generation-skipping transfers occurring) after Dec. 31, 2009. However, for gifts made, decedents dying, and generation-skipping transfers occurring after 2010, the law, as in effect immediately prior to EGTRRA, will be re-enacted. Changes to these provisions may affect the appropriateness and efficacy of the techniques discussed.

INSURANCE PRODUCTS:		
NOT INSURED BY FDIC OR ANY FEDERAL GOVERNMENT AGENCY	MAY LOSE VALUE	NOT A DEPOSIT OF OR GUARANTEED BY ANY BANK OR ANY BANK AFFILIATE

What is Wealth Transfer Planning?

Essentially, wealth transfer planning is the process of positioning assets that will not be needed during a person's lifetime so that they may be transferred in an efficient manner to the next generation. An effective wealth transfer plan will allow you to transfer wealth to your heirs in a financially sound and, in some cases, a tax-advantaged manner.

Who Needs to Plan for Wealth Transfer?

Most anyone should be concerned with wealth transfer planning at some level. A common misconception about wealth transfer planning is that it is only for the wealthy. While the wealthy may require sophisticated estate planning, wealth transfer planning is beneficial to everyone who has assets that will need to be transferred upon death. Depending on a person's age, family status and asset mix, the wealth transfer process may be as simple as repositioning assets or establishing a will. It could also be as complex as establishing and funding trusts, or setting in place a variety of tax-reducing strategies.

In general, estate planning and wealth transfer planning are both necessary if a person's assets total more than the current applicable exclusion amount in any given year (see chart, Estate and Gift Taxes). Even though the applicable exclusion amount may increase under the Economic Growth and Tax Relief Reconciliation Act* of 2001, $1 million may be a proper baseline because it is the scheduled amount in 2011 when the estate tax is scheduled to revert to prior law.

*According to the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), the estate tax will remain at 45% until it is finally repealed in 2010. Barring an additional act of Congress, it will be fully reinstated in 2011 at rates and exclusion amounts in effect prior to EGTRRA. In addition, tax law could change as congressional and presidential elections alter the political landscape.

Federal Estate and Gift Taxes: An Overview

Estate Taxes

The federal estate tax is a tax on the transfer of an estate at death. To eliminate the burden of the estate tax on the majority of estates, the federal government provides that no tax will be due unless the value of the taxable estate exceeds a certain threshold on the date of death. This threshold is referred to as the Applicable Exclusion Amount. Estate taxes are assessed on all assets that exceed the applicable exclusion threshold. Transfers made to either public or private charities are not subject to estate tax. Furthermore, most transfers made to a surviving spouse qualify for an unlimited marital deduction, which has the effect of delaying the estate tax until the death of the surviving spouse.

The following list indicates the appropriate Applicable Exclusion Amount through 2011.

2007 – $2,000,000
2008 – $2,000,000
2009 – $3,500,000
2010 – No estate tax
2011+ – $1,000,000

The actual amount of estate tax due on any particular estate depends on the size of that estate. The following list shows the top estate tax rates from years 2007 - 2011.

2007 – 45%
2008 – 45%
2009 – 45%
2010 – n/a
2011+ – 55%

Gift Taxes

To prevent people from avoiding the federal estate tax by giving away all their assets during their lifetime, the federal government imposes a gift tax when property is gifted from one person to another. There are two significant exceptions to the gift tax.

The first exception is referred to as the annual gift tax exclusion and it allows every U.S. citizen or resident alien to give away $12,000 per person, per year. To be eligible for this annual exclusion, the gift must be a gift of a present interest. Present interest gifts can be made with any type of transferable property, including cash or stock. For various reasons, many people choose to make present interest gifts in trust, rather than outright gifts to the recipient. Special trust powers, known as “Crummey powers,” allow gifts made in trust to qualify for the annual exclusion.

The second exception to the gift tax is the lifetime gift tax exemption. This exemption provides that every U.S. citizen or resident alien can transfer $1,000,000 during his or her lifetime without paying any gift tax. This exemption applies in addition to the annual gift tax exclusion. However, unlike the annual gift tax exclusion, any use of the lifetime gift tax exemption amount reduces the available estate tax exclusion amount by the amount of the gift. For example, if a person makes a lifetime gift of $500,000, that person’s estate tax exemption at death is reduced by the same $500,000 (i.e., it would be reduced to $1,500,000 if the death occurred in 2007). Since the lifetime gift tax exemption is limited to $1,000,000, gift taxes will be owed on any gifts when the cumulative total (excluding any annual exclusion gifts) exceeds $1,000,000.

Why Gifting Matters

The unified nature of the estate and gift tax exemptions is intended to reduce or eliminate the benefit of lifetime gifts when compared to transfers at death. However, there is still a significant benefit to making lifetime gifts because any appreciation made after the date of the gift is excluded from the estate of the person who made the gift. For this reason, people typically plan to maximize the use of their lifetime exemption by making gifts of property, such as business interests or real estate, that are likely to appreciate significantly in the future.

Using Life Insurance to Transfer Wealth

The Basics

Life insurance is a unique financial instrument designed to provide liquidity at death. What makes life insurance unique is that it is the only financial instrument designed specifically for this purpose. The tax characteristics of life insurance are consistent with its purpose. During the life of the insured, the cash values, if any, contained within a life insurance policy accumulate tax-deferred so that the withdrawn cash value does not create any adverse income tax consequences to the policyowner. When the insured dies, the life insurance proceeds are generally paid federal income tax-free to the policy beneficiary.

Irrevocable Life Insurance Trusts for Wealth Transfer

When estate taxes are not a concern, it is very common for one spouse to be the owner and beneficiary of a life insurance policy on the life of the other spouse. However, when estate taxes are a concern, life insurance is typically not owned by either the insured or the spouse, but rather by a third-party. Properly structured third-party ownership is important because it prevents the life insurance proceeds from being includable in the estate of the insured, or the insured’s spouse, which prevents the proceeds from being subject to estate taxes, either for the insured or the insured’s spouse. Third-party ownership can eliminate the life insurance proceeds from the estate of the insured and an Irrevocable Life Insurance Trust (ILIT) is often a preferred third-party owner. An ILIT is a specially drafted irrevocable trust designed to hold a life insurance policy. Among other things, the irrevocable nature of the trust prevents the policy proceeds from being includable in the estate of the insured. Other non-tax benefits include the ability to “control from the grave” by associating limitations or incentives on trust distributions, asset protection for the beneficiaries, and the ability to use one policy to benefit multiple beneficiaries.

When establishing an ILIT, it’s important that an amount equal to the life insurance premiums be gifted to the trust so that it can pay the necessary premiums. In most cases, proper trust drafting will allow the premium gifts to qualify for the annual gift tax exclusion. In cases where the premium exceeds the available annual exclusions, some of the client’s lifetime gift tax exemption may need to be used. Otherwise, gift tax consequences may apply. Using all or part of the lifetime exemptions to purchase life insurance within an irrevocable trust is often viewed as an effective way to leverage the lifetime exemption because the policy death benefit may be multiples of the policy premium (depending on your age, risk class and when you die).

Life insurance policies contain fees and expenses, including cost of insurance, administrative fees and premium loads, surrender charges and other charges or fees that will impact policy values. Variable universal life insurance policies also have additional charges and fund operating expenses. Both the investment return and principal value will fluctuate so that shares, when redeemed, may be worth more or less than their original cost.

Irrevocable Life Insurance Trusts – How They Work

An Irrevocable Life Insurance Trust (ILIT) is designed to hold life insurance and to pass the death benefit of the policy on to the trust beneficiaries in the most tax-efficient manner. To accomplish its purpose, the Irrevocable Life Insurance Trust must be both the owner and beneficiary of the policy. The life insurance premiums are typically paid with gifts made to the trust from the creators of the trust. In many situations, gifts made to an Irrevocable Life Insurance Trust will qualify for the annual gift tax exclusion so that there are no adverse gift tax consequences associated with the gifts to the trust.

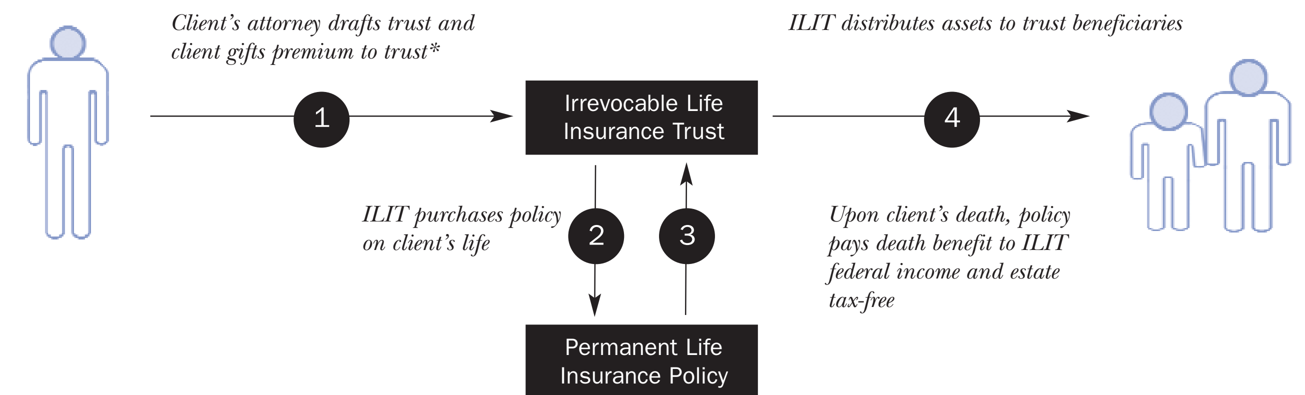
Upon the death of the insured, the trust, as owner and beneficiary of the policy, will collect the life insurance death benefit proceeds from the insurance company and distribute or hold them according to the trust document. The life insurance proceeds are generally received income tax-free by the trust, and, assuming the trust is property drafted and administered, the life insurance proceeds will also be outside the estate of the insureds.

Client Profile

- Ages: All
- Need for life insurance death benefit
- Any individual or couple that has a potential estate tax liability
- Any individual or couple with large amounts of illiquid assets
- Individuals looking to benefit multiple people with one policy
- Insurable

How it Works:

1. The client's attorney drafts an Irrevocable Life Insurance Trust into which the client makes gifts.*
2. The trust purchases life insurance on the client's life with dollars gifted to the trust by the client.
3. Upon the death of the client, the life insurance death benefit will be paid federal income and estate tax-free to the trust and will be distributed according to the trust document.
4. ILIT distributes assets to trust beneficiaries.



*There may be federal gift taxes associated with the funding of an Irrevocable Life Insurance Trust.

TRUST PLANNING

Credit Shelter Trust with Life Insurance

A properly designed credit shelter trust strategy helps ensure that both spouses' applicable exclusion amounts are fully utilized and not wasted. The strategy is accomplished by transferring into the trust an amount equal to the applicable exclusion amount upon the death of the first spouse. The credit shelter trust (CST) – also called a B-Trust or a family trust – usually provides that the surviving spouse shall receive all the income from the trust at least annually and the children will receive the principal of the trust upon the death of the surviving spouse.

As a result of this common estate planning technique, many wealthy widows or widowers end up the beneficiary of a credit shelter trust. In many cases, the trust was set up for the sole purpose of reducing the estate tax exposure of the combined estate and the surviving spouse who is the receiving income payments from the trust may not actually need those income payments to support his or her standard of living.

If the surviving spouse does not need the income from the credit shelter trust and would like to potentially help increase the amount of wealth passing to the trust beneficiaries, the surviving spouse can consider allowing the trustee to purchase life insurance on his or her life within the trust. This strategy may provide a number of potential benefits, including helping to increase the wealth transfer and an effective "step-up" in cost basis on the life insurance death proceeds because of the tax-free receipt of the life insurance death benefit by the trust.* In addition, any growth in the life insurance policy cash values will be on a tax-deferred basis and should not generate any income, or income tax, for the surviving spouse.

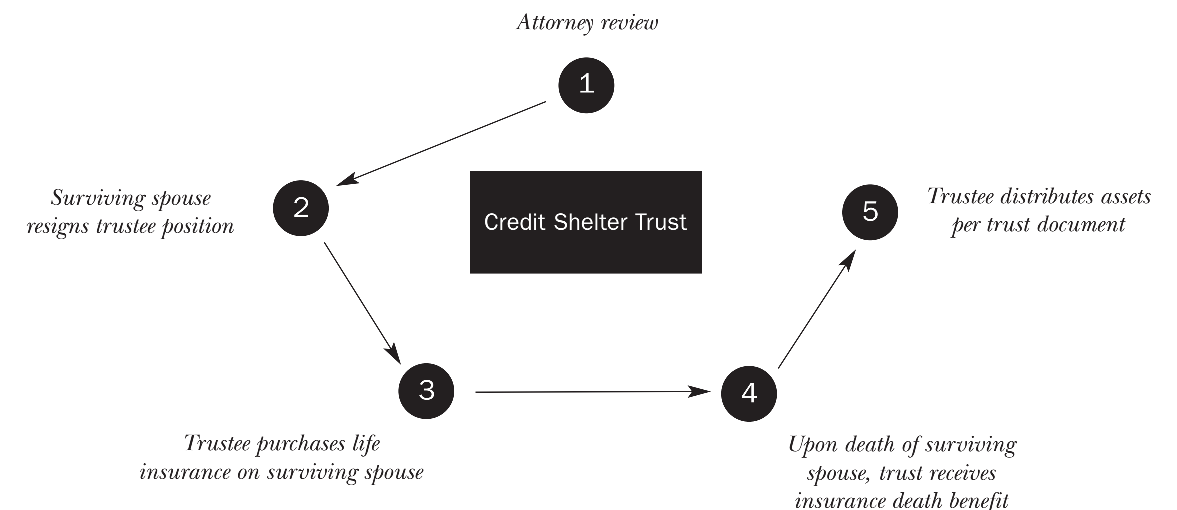
*Not all credit shelter trusts can purchase life insurance on the surviving spouse. As with all tax and legal matters, clients interested in this strategy should consult their own tax or legal advisor.

Client Profile

- Widow or widower age 85 or younger who is a beneficiary of a credit shelter trust
- Wants to pass as much wealth as possible to trust beneficiaries
- Surviving spouse does not need the income being distributed from the credit shelter trust
- Would like to receive a "step-up" in cost basis on the life insurance death proceeds within the trust at his or her death

How it Works:

1. Surviving spouse has attorney review trust document to determine if trustee can purchase life insurance within the credit shelter trust.
2. Surviving spouse resigns from trustee position (if applicable).
3. Trustee purchases life insurance on life of surviving spouse.
4. Upon the death of surviving spouse, the trust receives the insurance death benefit federally income and estate tax free.
5. Trustee distributes assets per trust document.



TRUST PLANNING

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Survivorship Access Trust

A survivorship access trust is a specially drafted Irrevocable Life Insurance Trust (ILIT) for married couples. It is designed to keep second-to-die life insurance proceeds outside the estate of both insureds and still allow indirect access to the account value of the life insurance policy to one spouse through an independent, third-party trustee.

Under this strategy one spouse, the grantor, makes annual exclusion gifts to the access trust. The trustee uses the gifts from the grantor to purchase a second-to-die life insurance policy on the life of both spouses. The other spouse, the non-grantor, along with the couple's children, are beneficiaries of the trust. Under the terms of the trust document, the trustee may make discretionary distributions of the trust income and/or principal to any of the trust beneficiaries, including the non-grantor spouse.* When properly structured, a survivorship access trust allows for clients to take advantage of a federal estate tax-free death benefit while allowing one spouse indirect access through the trustee to the life insurance cash values through policy loans and withdrawals.

Both loans and withdrawals from a permanent life insurance policy may be subject to penalties and fees and, along with any accrued loan interest, will reduce the policy's Account Value and Death Benefit.

Using his or her annual gift tax exclusion amount, the grantor spouse may gift up to $12,000 annually per beneficiary of the trust (excluding the non-grantor spouse beneficiary) without federal gift tax consequences. It is important that the non-grantor spouse not make any direct or indirect gifts to the trust because any gifts by the non-grantor spouse could result in estate tax inclusion. Even though the non-grantor spouse cannot make any direct or indirect gifts to the trust, he or she may still be able to consent to gift splitting. Splitting gifts would allow the grantor spouse to double his or her gifting amount to $24,000 per beneficiary, per year. Clients should consider how future life insurance premiums would be paid if the grantor spouse dies first, since the non-grantor spouse cannot make gifts to the trust.

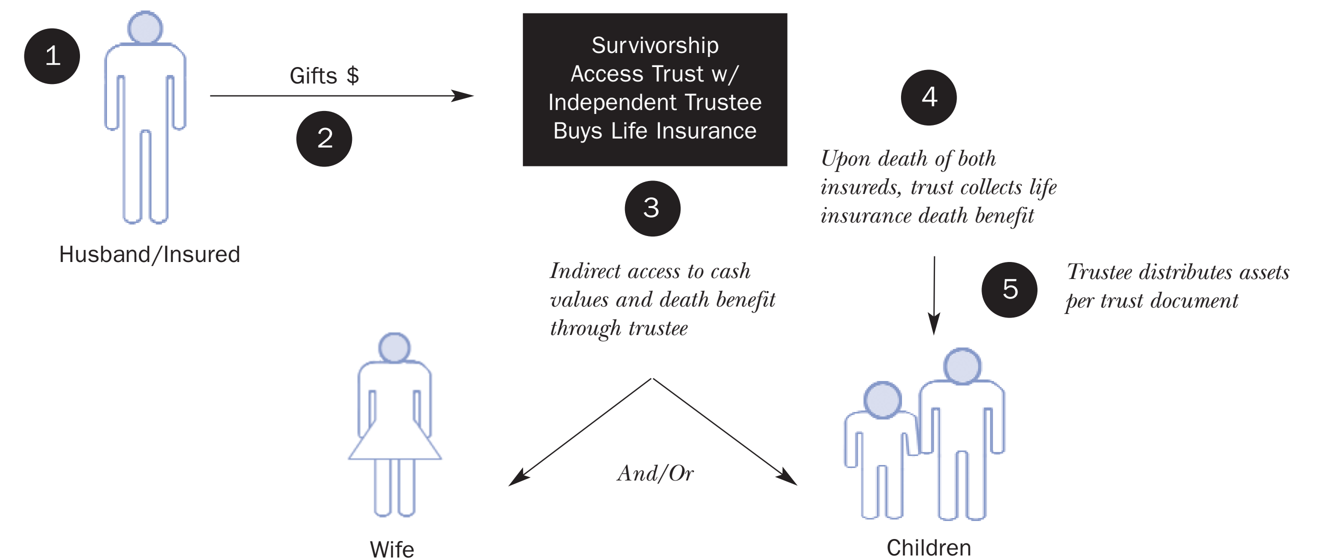
* A gift tax return will need to be filed by both spouses if they elect to split gifts in excess of the annual exclusion amount. A question remains whether or not the mere filing of a gift tax return makes the non-grantor spouse a grantor. There may be estate tax consequences if the filing of a gift tax return does make the non-grantor spouse a grantor.

Client Profile

- Married couples who are insurable and who need second-to-die life insurance protection
- Understands the benefits of adding life insurance to a wealth transfer plan
- Wants one spouse to have some ability to indirectly access the cash values of the life insurance, but also wants the proceeds excluded from both spouses' estates

How it Works:

1. One spouse, the grantor spouse, makes gifts of cash to an Irrevocable Life Insurance Trust drafted as a survivorship access trust (SAT).
2. The 3rd party trustee of the SAT purchases a second-to-die life insurance policy with the gifted cash.
3. During the lifetime of the insureds, the trustee may make discretionary distributions of the policy's cash value through loans and withdrawals to either the non-grantor spouse or the children.*
4. Upon the death of both insureds, the trust collects the life insurance death benefit proceeds federal income and estate tax-free.
5. Trustee distributes assets per trust document.



* Both loans and withdrawals from a permanent life insurance policy may be subject to penalties and fees and, along with any accrued loan interest, will reduce the policy's Account Value and Death Benefit. Depending upon the performance of a VUL policy's investment choices, the Account Value may be worth more or less than the original amount invested in the policy. Assuming a policy is not a Modified Endowment Contract (MEC), loans are free from current Federal taxation and withdrawals are taxed only to the extent that they exceed the policyowner's basis in the policy. Distributions from MECs are subject to Federal income tax to the extent of the gain in the policy and taxable distributions are subject to a 10% additional tax, with certain exceptions.

TRUST PLANNING

TRUST PLANNING

Dynasty Trust Planning

The generation skipping transfer tax is assessed on transfers of property to a generation two or more generational levels below the transferor. The purpose of the generation-skipping tax is to prevent people from avoiding the estate tax at any particular generational level by simply skipping over that generation in favor of more remote generations. Like the estate and gift tax, people are also allowed an exemption from the generation-skipping tax. The exemption amount is equal to the estate tax exemption amount and is currently $2,000,000 per person.

A dynasty trust is an irrevocable trust designed to last for many generations. The key to an effective dynasty trust is to increase the use of the generation-skipping transfer (GST) tax exemptions while still complying with the estate and gift tax rules. Life insurance is often a preferred funding vehicle for a dynasty trust because it is designed to help increase wealth transfer, it provides for tax-deferred accumulation, and the death benefit provides an effective "step-up" in basis upon the death of the insured(s). The effective step-up occurs because the death benefits are paid federally income tax free to the trust. By funding a dynasty trust with life insurance, you can potentially increase the amount of wealth transferred to future generations, estate and generation-skipping, transfer tax-free.

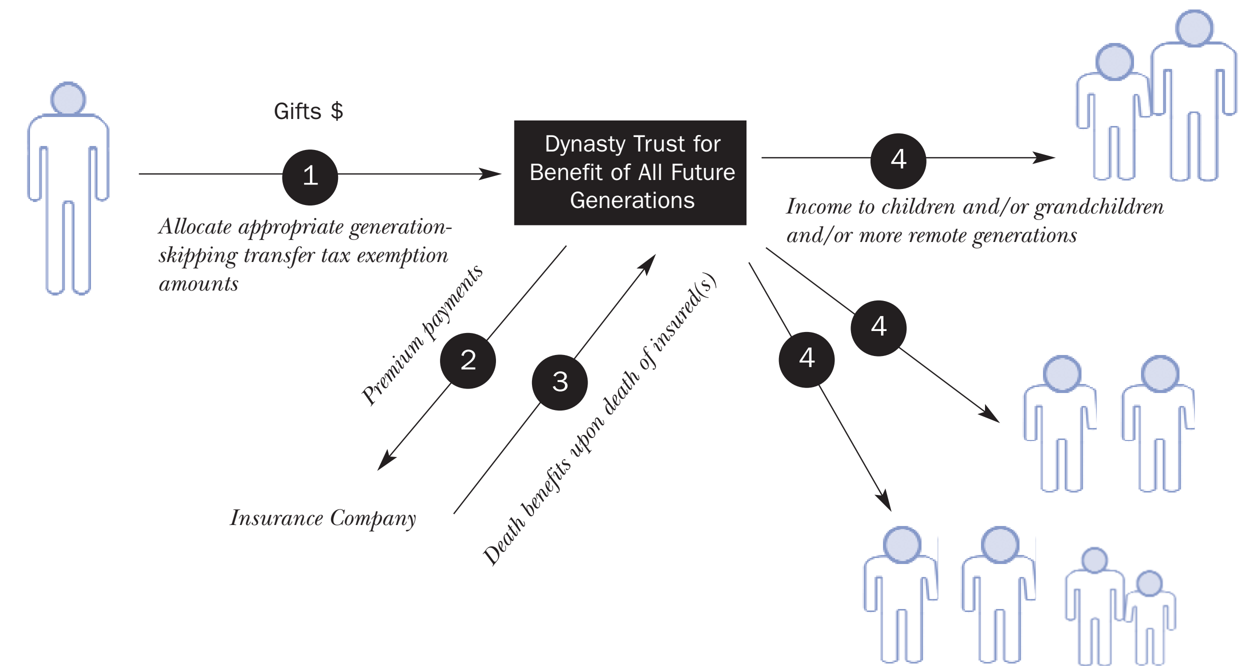
Whenever discussing the possibility of a trust lasting into perpetuity (forever), the Rule Against Perpetuities must be discussed. The Rule Against Perpetuities is a common law rule that provides that no interest in property is valid unless the interest vests no later than 21 years after the life or lives in being when the interest is created. This rule is very complex and a full explanation is beyond the scope of this brochure. What you need to remember is that there are state laws that limit the amount of time that a trust can last. Partly because of the complexity of the law, and the fact that the law dates back to the Duke of Norfolk's Case in 1682, many states have modified or abolished the law. The following states have effectively abolished or repealed the Rule Against Perpetuities: AK, AZ, CO, DE, ID, IL, ME, MD, MO, NE, NJ, OH, RI, SD, VA, and WI. In addition, Wyoming and Utah allow a trust to last for 1,000 years, Florida allows a trust to last for 360 years and in Washington state, a trust can last for 150 years. It may be possible to have the trust domiciled in a state that is not the resident state of the grantors. Assuming the individual state requirements for the trust to the domiciled in that state can be met, clients can have the choice of what state laws they want to follow. (Please note: for tax purposes, the trust could be subject to the laws of multiple states.)

Client Profile

- Wealthy families where wealth will ultimately be passed from generation to generation
- Clients who want to remove large amounts of wealth from the estate tax system
- Clients who want to create a "family dynasty"
- Clients who want to provide income for the next generations, including children and grandchildren
- Clients interested in creditor protection (Creditor protection is for the trust beneficiaries because they do not generally have outright ownership.)

How it Works:

1. Grandparents create a dynasty trust; they gift money to the trust and allocate their appropriate generation-skipping tax exemptions to the gifts.*
2. Dynasty trust purchases life insurance on the life of the grandparents.
3. Death benefits are paid to trust upon death of grandparents.
4. Trust makes distributions of income and principal to children and/or grandchildren and/or more remote generations for as long as possible under the applicable state law.



*There may be federal gift tax consequences associated with the funding of a dynasty trust.

TRUST PLANNING

Charitable Remainder Trust

A charitable remainder trust (CRT) is a split interest trust with both a charitable beneficiary and a non-charitable beneficiary. Through the use of a charitable remainder trust, clients can benefit themselves and their favorite charity. The benefits to the client are typically an income tax deduction which is large or small, depending on that portion of the trust that will benefit the charity and an income stream for either a set number of years (not to exceed 20) or for the rest of the client's life. The charity benefits because at the end of the specified term, or when the client dies, the remaining balance in the CRT passes to the charity.

In most instances, clients choose to give highly appreciated capital gain assets to CRTs. This is because the tax laws allow for clients to receive an income tax deduction on the property that is being contributed, based on the full, appreciated value of the property, even though the client has not yet recognized the appreciation in income. Once the asset has been contributed to the CRT, the trustee will typically sell the appreciated asset. Since the CRT is a tax-exempt entity, no income tax will be currently due upon the sale. In some cases, the fact that no income taxes are due upon the sale also helps increase the client's income stream because, depending on how the trust is designed, the income stream may be based on a percentage of the trust assets.

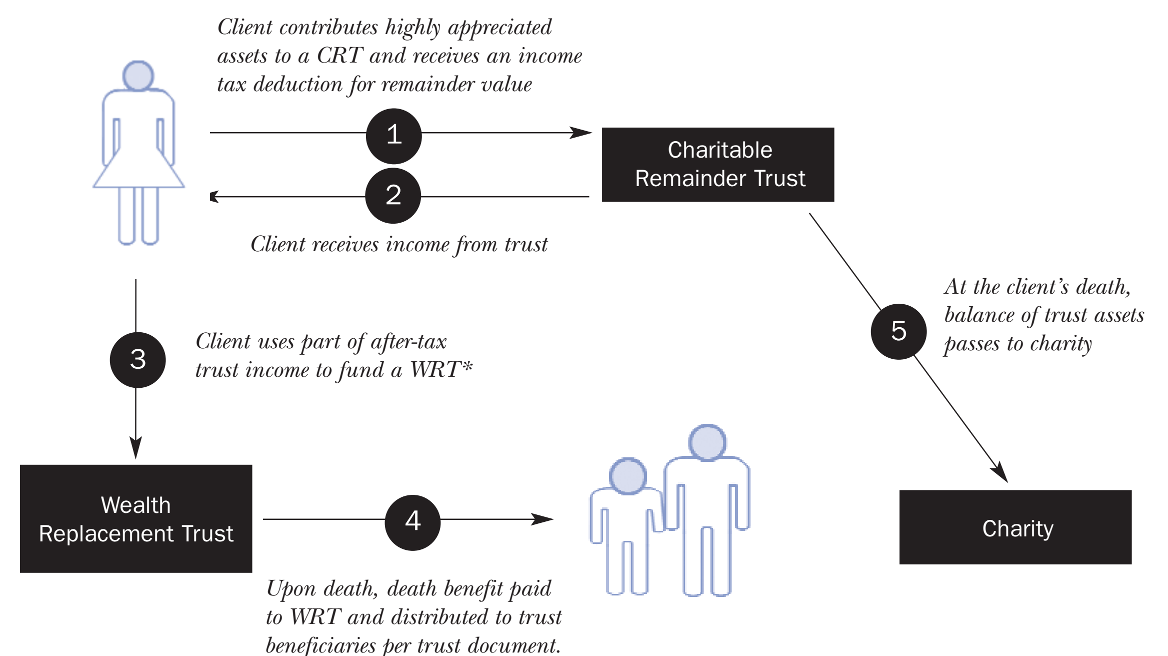
Because the remaining balance of the CRT will eventually be passed to a charity and not to the client's family, many clients choose to purchase life insurance inside a wealth replacement trust to replace the value of the assets given to the charity at death. A wealth replacement trust is an irrevocable trust designed to hold a life insurance policy outside the estate of the insured(s). There may be federal gift tax consequences associated with the funding of a trust. By combining a CRT with life insurance in a wealth replacement trust, clients may be able to leave a significant benefit for their favorite charity and still transfer wealth to their heirs.

Client Profile

- Generally age 50+, insurable
- Charitably inclined
- Has appreciated capital gain assets
- In need of an income tax deduction
- Looking for additional income

How it Works:

1. A client irrevocably gifts assets (usually highly appreciated) to a charitable remainder trust. The donor is entitled to an immediate federal income tax deduction for the present value of the remainder gift to charity. (Any unused federal income tax cannot be deducted in the current year, but may be carried over for a maximum of five additional years.)
2. The trustee typically sells the assets and reinvests them. Since the CRT is a tax-exempt trust, no taxes are currently due upon the sale. The trust then pays the income beneficiary (usually the donor) a fixed payment or fixed percentage of trust assets for a period of lives or a term of years (not to exceed 20).
3. The income beneficiary uses part of the after-tax income stream to make premium gifts to a wealth replacement trust (WRT). The WRT purchases life insurance designed to replace the value of the assets for the children.*
4. Upon the death of the client, the life insurance death benefit is paid to the WRT and subsequently distributed to the client's beneficiaries per the trust document.
5. At the same time, the charity receives the balance remaining in the CRT.



*There may be federal gift tax consequences associated with the funding of a Wealth Replacement Trust.

Asset Protection+

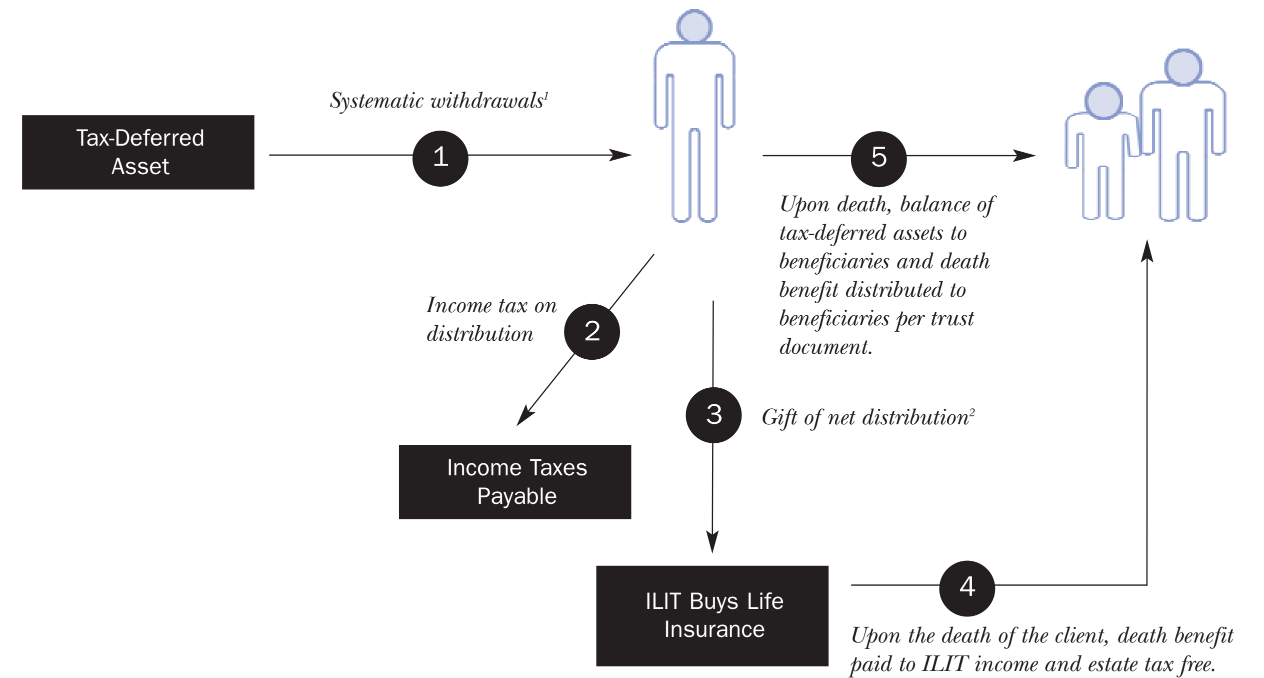
Asset Protection+ is the concept of repositioning assets during your lifetime to help protect them from taxes and other transfer costs at death. This strategy may be employed for any type of asset, but is most often used with tax-deferred assets, such as qualified plan balances, IRAs and non-qualified annuities that are not going to be utilized during a person's lifetime. Often, it makes sense to reposition these assets because if left alone, they could possibly be subject to both estate taxes at death and income taxes upon withdrawal. The combined effect of these taxes can result in reducing a person's wealth by approximately 65 percent. Life insurance is often the ideal financial instrument in which to reposition assets because the death benefits are generally received federal income tax-free. The policy may be held by a properly structured Irrevocable Life Insurance Trust (ILIT), where the proceeds may be received estate tax-free, too.

Client Profile

- Large non-qualified tax-deferred asset, qualified plan or traditional IRA balance
- Generally age 60+
- Does not need to use this asset during their lifetime
- Account subject to estate taxes
- Does not want beneficiary to pay income taxes on asset balance
- Wants to reduce the burden of income and/or estate taxes for beneficiaries

How it Works:

1. Client takes systematic withdrawals from a tax-deferred asset, such as a non-qualified annuity, IRA, or from a qualified plan.
2. Client pays applicable income tax, and gifts the net after-tax proceeds to an irrevocable life insurance trust (ILIT).
3. ILIT purchases life insurance on the client's life.
4. Upon the death of the client, death benefit paid to ILIT income and estate tax free.
5. Also, upon death of the client, death benefit distributed to beneficiaries per trust document, along with the remaining balance of the tax-deferred assets.



[1] Taxable distributions, (and certain deemed distributions) are subject to ordinary income tax and, if made prior to age 59½, may also be subject to a 10% federal income tax penalty.

[2] There may be federal gift tax consequences associated with the funding of an Irrevocable Life Insurance Trust.

Municipal Bond Legacy +
Municipal bond income is generally not subject to federal income taxes. However, many municipal bond owners overlook the fact that the bond itself is subject to estate taxes upon the death of the owner. Municipal Bond Legacy + is the strategy of repositioning all or some of the municipal bond portfolio into life insurance as a means to help increase overall wealth transfer.

The traditional approach is to use the bond income for the purchase of life insurance inside an Irrevocable Life Insurance Trust (ILIT). However, if the bond owner is unable or unwilling to give up the bond income, an alternative approach may be taken. Under this approach, the client sells the bond and purchases a single premium immediate annuity (SPIA) with the after-tax proceeds. Depending on the age of the client, as well as other factors, the SPIA may provide a larger net after-tax income stream to the client than the bonds were providing. The difference between the net annuity payment and the previous bond income is used to make gifts to an Irrevocable Life Insurance Trust for the purchase of a life insurance policy outside the estate of the insured(s). There may be federal gift tax consequences associated with the funding of a trust. The life insurance policy is used to replace all or a portion of the municipal bond balance. The result is that the client's net income stays about the same and the client's family, as beneficiaries of the ILIT, receive the desired replacement value of the municipal bond, since the ILIT received the life insurance death benefit federal income and estate tax-free.

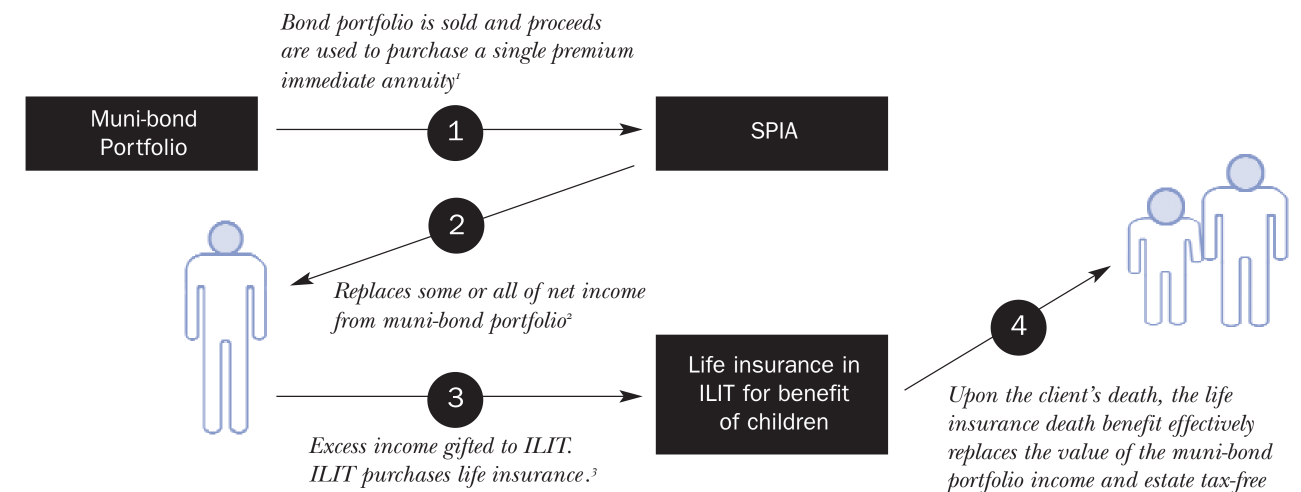
Client Profile

- Age: 60+
- Large municipal bond portfolio
- Potentially taxable estate
- Wants to reduce the burden of income and/or estate taxes for beneficiaries.

ASSET REPOSITIONING

How it Works:

1. A client with a large municipal bond portfolio sells some or all of the bonds[1] and chooses to purchase a single premium immediate annuity (SPIA) with the proceeds.
2. The net income from the SPIA[2] replaces some or all of the income the muni-bonds were generating.
3. With the remaining SPIA income, which was not needed for living expenses, the client makes gifts to an ILIT for the purchase of life insurance.[3]
4. Upon the death of the client, the annuity payments end, and the trust receives the life insurance death benefit proceeds income and estate tax-free for the benefit of the trust beneficiaries, effectively replacing the desired value of the municipal bond portfolio.



[1] There may be applicable fees, charges and taxes associated with liquidating your client's municipal bonds.
[2] Taxable distributions (and certain deemed distributions) are subject to ordinary income tax.
[3] There may be federal gift tax consequences associated with the funding of an Irrevocable Life Insurance Trust.

ASSET REPOSITIONING

Multi-Generational IRA

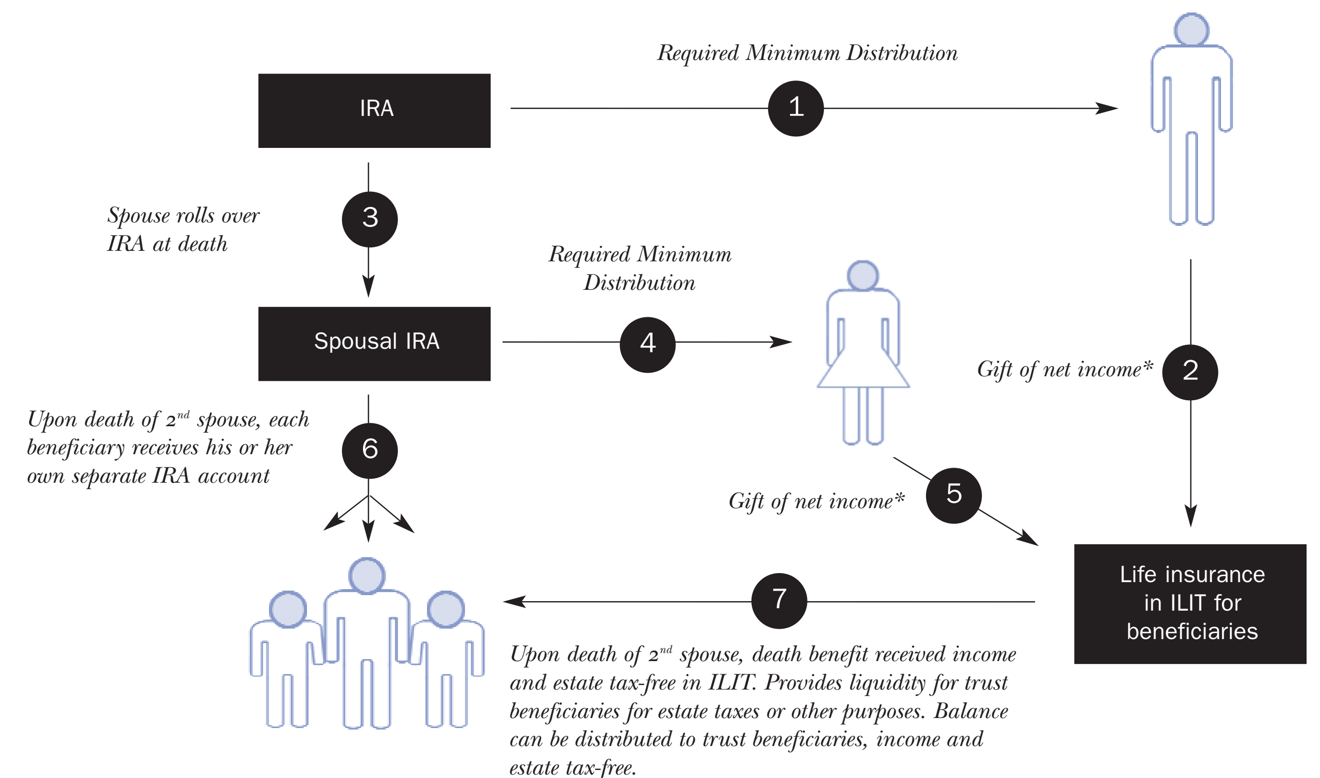
Leaving an IRA in tax-deferred status for as long as possible enhances the benefits of the tax deferral for future beneficiaries. However, there are three keys to success. First, no more than the required minimum distribution should be taken each year. This ensures that the maximum amount stays tax deferred within the IRA. Next, the proper beneficiary designations must be made so that each beneficiary can take required minimum distributions based on his or her own life expectancy and continue to defer the income taxes for as long as possible after the death of the IRA owner. Lastly, and in some cases most importantly, the clients must ensure that there is enough liquidity outside of the IRA to pay any estate taxes that may be due upon the IRA balance passing to the beneficiaries. If the IRA itself must be used to pay the estate taxes, it could significantly reduce the IRA balance and therefore reduce the overall benefit of the multi-generational IRA planning. One way to provide liquidity in a cos-efficient manner is to use all or a part of the IRA owner's net required minimum distributions to purchase life insurance inside a properly structured Irrevocable Life Insurance Trust outside the estate of the insured(s). The liquidity in the ILIT can help recover some of the amount lost to taxes.

Client Profile

- Has a large IRA
- Generally age 60+
- Does not/will not need RMDs or IRA income for living expenses
- Wants beneficiaries to receive a high potential value of IRA asset
- Wants IRA to be left intact for beneficiaries to accumulate tax-deferred
- Current or future IRA value potentially subject to estate taxes

How it Works:

1. A client with a large IRA takes only required minimum distributions.[1]
2. With gifts of net income from the distributions, the client funds an Irrevocable Life Insurance Trust*, which in turn purchases a second-to-die life insurance policy on the IRA owner and spouse.
3. Upon the death of the IRA owner, the surviving spouse elects a rollover to her own IRA.
4. The surviving spouse continues to take only required minimum distributions.[1]
5. The surviving spouse continues to use part or all of the net IRA distributions to fund the ILIT.
6. Upon the death of the second spouse, the remaining IRA balance is placed in a separate IRA for each beneficiary so that each individual beneficiary may take required minimum distributions based on his or her individual life expectancy.
7. At the same time, the ILIT receives the life insurance proceeds federal income and estate tax free. These proceeds may provide liquidity for the trust beneficiaries to pay any estate taxes or other settlement costs they owe, leaving the remaining separate IRA accounts intact to accumulate tax-deferred.



*There may be federal gift tax consequences associated with the funding of an ILIT.

[1] Taxable distributions (and certain deemed distributions) are subject to ordinary income tax.

Multi-Generational IRA with Roth Conversion

By properly naming IRA beneficiaries and taking only the required minimum distributions, clients can enhance the benefit of tax deferral and stretch their IRA balances out over multiple generations and potentially increase wealth transfer. The benefits of a multi-generational IRA may be further enhanced by converting from a traditional IRA to a Roth IRA for a number of reasons. One reason is there are no required minimum distributions from a Roth IRA during the life of the IRA owner. (Note: Taxes are due at the time of the conversion.) This ability to defer taking required minimum distributions until the death of the IRA owner further enhances the tax deferral feature of the IRA. Another and perhaps even more significant reason is that qualified distributions are not subject to income tax. By properly establishing a multi-generational Roth IRA, clients can potentially pass on tax-free income to multiple generations.*

Here's how a multi-generational Roth IRA can be set up for married couples. The strategy is for the surviving spouse to convert the traditional IRA to a Roth IRA after the death of the IRA owner. As a result of the conversion, the full balance of the IRA will be subject to income tax. If the surviving spouse has to use the money from the IRA to pay the income tax, it could significantly reduce the total balance and the overall benefit of the multi-generational Roth IRA. Instead, to generate the liquidity necessary for paying the income taxes, life insurance is purchased ahead of time on the life of the original IRA owner using the net required minimum distributions. The life insurance death benefit is used to pay the income taxes due on the conversion.

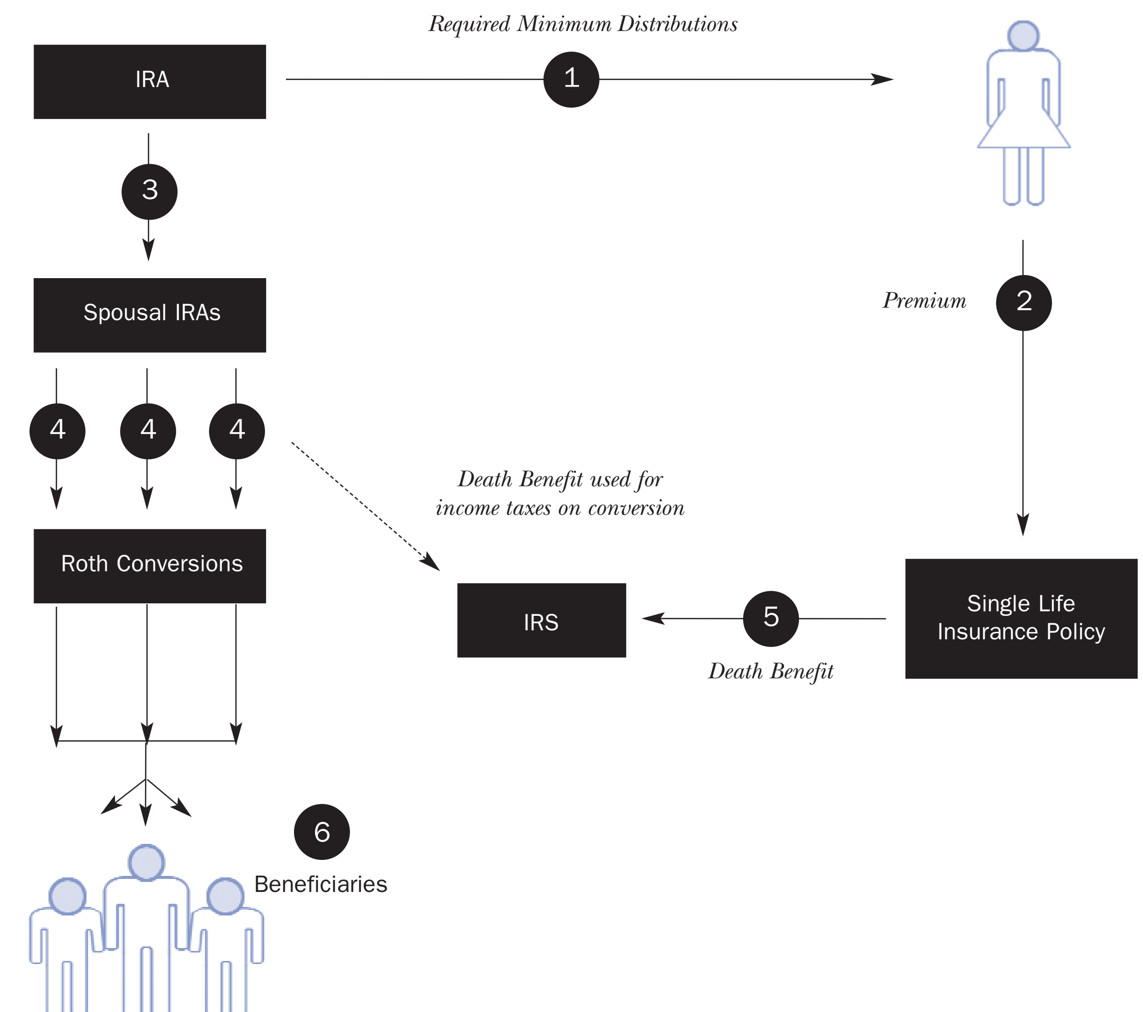
*For tax years beginning after 12/31/2009, the $100,000 AGI limit and filing status requirement to convert a traditional IRA to a Roth IRA is eliminated.

Client Profile

- Large IRA balance
- Generally age 60+
- Does not need IRA income for living expenses
- Wants to help ensure beneficiaries receive a high potential value of asset
- Does not want beneficiary to pay income taxes on distributions

How it Works:

1. A client with a large IRA takes required minimum distributions.[1]
2. With the net after-tax income, the client's spouse purchases a life insurance policy on the IRA owner's life and names herself as beneficiary (premiums are paid with the IRA owner's required minimum distribution).
3. Upon the death of the IRA owner, the surviving spouse rolls the IRA into a spousal IRA and creates separate accounts for each ultimate beneficiary.
4. Spouse converts traditional IRA to a Roth IRA.
5. The life insurance death benefit is used to pay the income taxes on the conversion.[2]
6. Spouse no longer needs to take RMDs. Upon her death, the full IRA balance passes to ultimate beneficiaries in separate accounts. Each beneficiary takes income tax free distributions over his or her own individual life expectancy.



[1] Taxable distributions (and certain deemed distributions) are subject to ordinary income tax and, if made prior to age 59½ may also be subject to a 10% federal income tax penalty.

[2] The remaining Roth IRA balance may be included in the owner's estate for federal estate tax purposes.

Sale to Intentionally Defective Irrevocable Grantor Trust

In some cases, single asset estate planning is not appropriate. Your clients with very high net worth often require more sophisticated estate planning and wealth transfer techniques. One popular strategy for high net worth people is to sell assets to an Intentionally Defective Irrevocable Grantor Trust (IDIGT) in order to remove as much appreciation as possible from their estates.

Simply stated, an Intentionally Defective Irrevocable Grantor Trust is one that is ignored for income tax purposes but valid for estate and gift tax purposes. When properly structured, transactions, such as sales, between the trust and the grantor will be ignored for income tax purposes. With the help of their attorney, clients create an Intentionally Defective Irrevocable Grantor Trust and seed the trust with an initial contribution (typically about 10% of the value of the property that will subsequently be sold to the trust). After the trust is seeded, clients sell assets (often, income- producing discounted assets based on a qualified appraisal, such as limited partnership interests or non-voting S Corp sales) to the trust for an interest-only note with a balloon payment after a specified duration. Because the trust is ignored for income tax purposes, the seller does not recognize gain upon the sale of the assets to the trust. The trustee then uses the income from the assets it just purchased to pay the interest on the note, which is typically set at the appropriate applicable federal rate for the term of the loan. All income in excess of the amount payable under the note remains an asset of the trust and outside the estate of the insured.

The note sale technique can be a powerful technique available for gift tax leveraging because the only taxable gift is the seed money. Since the gift of the seed money is typically less than the client's available gift tax and generation-skipping transfer tax exemptions, this technique is an excellent way to leverage both a client's generation-skipping tax exemption and lifetime gift tax exemption.

Life insurance is a crucial component of this technique. Typically, life insurance is purchased with the excess income retained by the trust and used for two purposes. First, life insurance provides a means of making the balloon payment on the note if the insured/seller dies before the note is fully repaid by the trust. Secondly, the life insurance death benefits can help increase the amount of wealth transfer possible by providing income tax-deferred accumulation and a federal income tax-free death benefit.

Client Profile

- High net worth
- Interest in generation-skipping tax planning
- Looking to enhance value of wealth that passes to multiple generations
- Has income-producing assets
- Has assets likely to appreciate significantly

How it Works:

1. Client and advisor create an Irrevocable Life Insurance Trust which is drafted as an Intentionally Defective Irrevocable Grantor Trust (IDIGT).
2. Client makes an initial gift of seed money to the trust (typically about 10% of the anticipated sale).
3. Client sells appreciating assets, such as limited partnership interests, to the trust for a note.
4. Trust uses income from the Family Limited Partnership interests it purchased to pay the interest due on the note to client.
5. Excess income is used to purchase a life insurance policy for wealth transfer and to ensure the trust has enough assets to pay off the note in the event of a premature death.

*There may be federal gift tax consequences associated with the sale of an ILIT.

The gift and note sale strategy is an advanced tax planning technique that may not be appropriate for all persons and should only be entered into with the advice of competent legal counsel.

There are certain ambiguities with regard to the income tax treatment of a grantor trust upon the death of the grantor. However, life insurance proceeds are generally received income tax free upon the death of the insured under Internal Revenue Code section 101(a).

Proper valuation of the property to be sold to the trust is critical because if the valuation is ultimately determined to be wrong, part of the sale transaction may be recharacterized as a gift.

In 2007, U.S. Citizens and resident aliens are entitled to a $1,000,000 lifetime gift tax exemption and a $2,000,000 generation-skipping transfer tax exemption.

Private Split Dollar Life Insurance with a Grantor Retained Annuity Trust

Combining the benefits of a split dollar life insurance arrangement with a grantor retained annuity trust or GRAT can help clients increase their wealth transfer.

The Split Dollar Arrangement

A split dollar life insurance ownership arrangement allows two parties to share the costs and benefits of a cash value life insurance policy. The costs and benefits are generally split so that one party, typically an insured (or an uninsured spouse) has an interest in the policy death benefit and cash values equal to the entire cash value of the policy. The other party, typically an Irrevocable Life Insurance Trust, has an interest in the net amount of risk in the life insurance policy. The party with an interest in the entire cash value of the policy pays the majority of the premium and the other party, typically the ILIT, will pay only that portion of the premium that represents the value of one year's worth of term insurance. This premium allocation typically allows for significant gift tax leverage because the only part of the premium that the ILIT must pay is the one-year term cost, which is usually only a fraction of the actual premium. The gift tax leverage achieved by the split dollar arrangement decreases as the insured gets older and the cost of the one-year term insurance increases. Ideally, the split dollar arrangement will be terminated before the term costs become prohibitive and after all the premiums have been paid. Termination may result in income tax and/or gift tax consequences.

One way to terminate a split dollar arrangement is to transfer additional funds to the Irrevocable Life Insurance Trust so that it can repay the other party its interest in the policy without impairing the life insurance policy. One of the most popular methods to achieve this is with a zeroed-out grantor retained annuity trust (GRAT).

How GRATs Work

In a GRAT, the grantor transfers property to the GRAT and retains an annuity interest in the transferred property for a number of years. When the term ends, the balance of the trust property is transferred to the remainder beneficiary of the GRAT. A GRAT can allow for significant gift tax leverage because, for gift tax purposes, the value of the gift to a GRAT is determined by subtracting the present value of the annuity interest from the total amount transferred to the trust. Ultimate gift tax leverage is accomplished by creating a zeroed-out GRAT. In this case, the present value of the annuity interest is equal to the value of the property contributed. A contribution to a zeroed-out GRAT does not produce a taxable gift, but can result in a significant amount of wealth being transferred from one party to another if the assets in the GRAT appreciate at a rate in excess of the annuity rate.[1] Naming an ILIT subject to a split dollar arrangement as the beneficiary of the GRAT may provide the ILIT with the funds necessary to terminate the split dollar arrangement in the future.

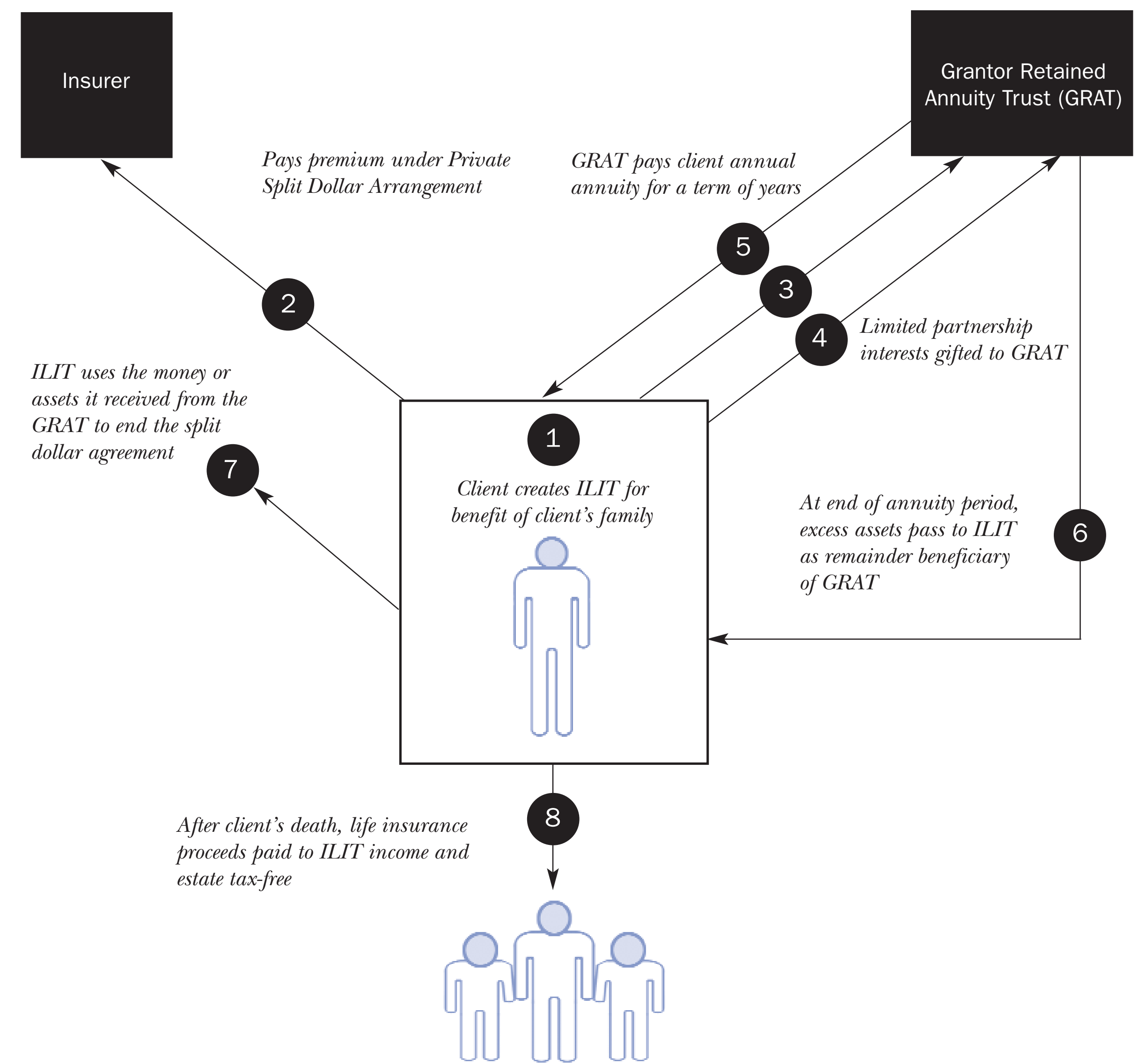
Client Profile

- High net worth
- Appropriate asset portfolio
  - Assets that can be discounted or transferred to an asset and discounted (such as a family limited partnership)
  - Highly appreciating assets
- Need for insurance policy with premiums in excess of available gifting exclusions

[1] It is important when transferring property to a GRAT that the transferred property is valued correctly. Inaccurate valuations can lead to adverse gift tax consequences.

How it Works:

1. Client creates Irrevocable Life Insurance Trust for the benefit of his or her family.
2. Client pays the premiums under a private split dollar arrangement with the Irrevocable Life Insurance Trust (ILIT).
3. Client then creates a Grantor Retained Annuity Trust (GRAT).
4. Client transfers limited partnership interests to the GRAT.
5. Under the terms of the GRAT, the client retains a qualified annuity interest (typically a fixed amount) for a term of years.
6. Upon the expiration of the term of years any assets remaining in the GRAT pass to the ILIT as remainder beneficiary of the GRAT.[1]
7. ILIT uses the assets it receives from the GRAT to end the split dollar arrangement with the client.
8. Upon the death of the client, the life insurance proceeds are paid to the ILIT income and estate tax-free.



[1] All or a portion of the property in the GRAT will be includable in the estate of the grantor if the grantor dies prior to the expiration of the GRAT.

ADVANCED ESTATE PLANNING

Charitable Lead Trust with Life Insurance

By combining the benefits of a testamentary charitable lead trust with life insurance, clients may significantly reduce their estate tax exposure, provide an annuity payment stream to a charity of their choice and may still be able to leave the entire value of their assets to their children.

A testamentary charitable lead trust is a split interest charitable trust established at death, to which a significant amount of a person's estate may be transferred. Under the terms of the trust, a charitable beneficiary receives an income stream for a number of years. Upon the expiration of the annuity payments, the remaining balance of the trust property is transferred to the decedent's non-charitable beneficiaries, typically his or her children. The strategy can result in significant estate tax benefits because the value of the income stream benefiting the charity is deductible for estate tax purposes.

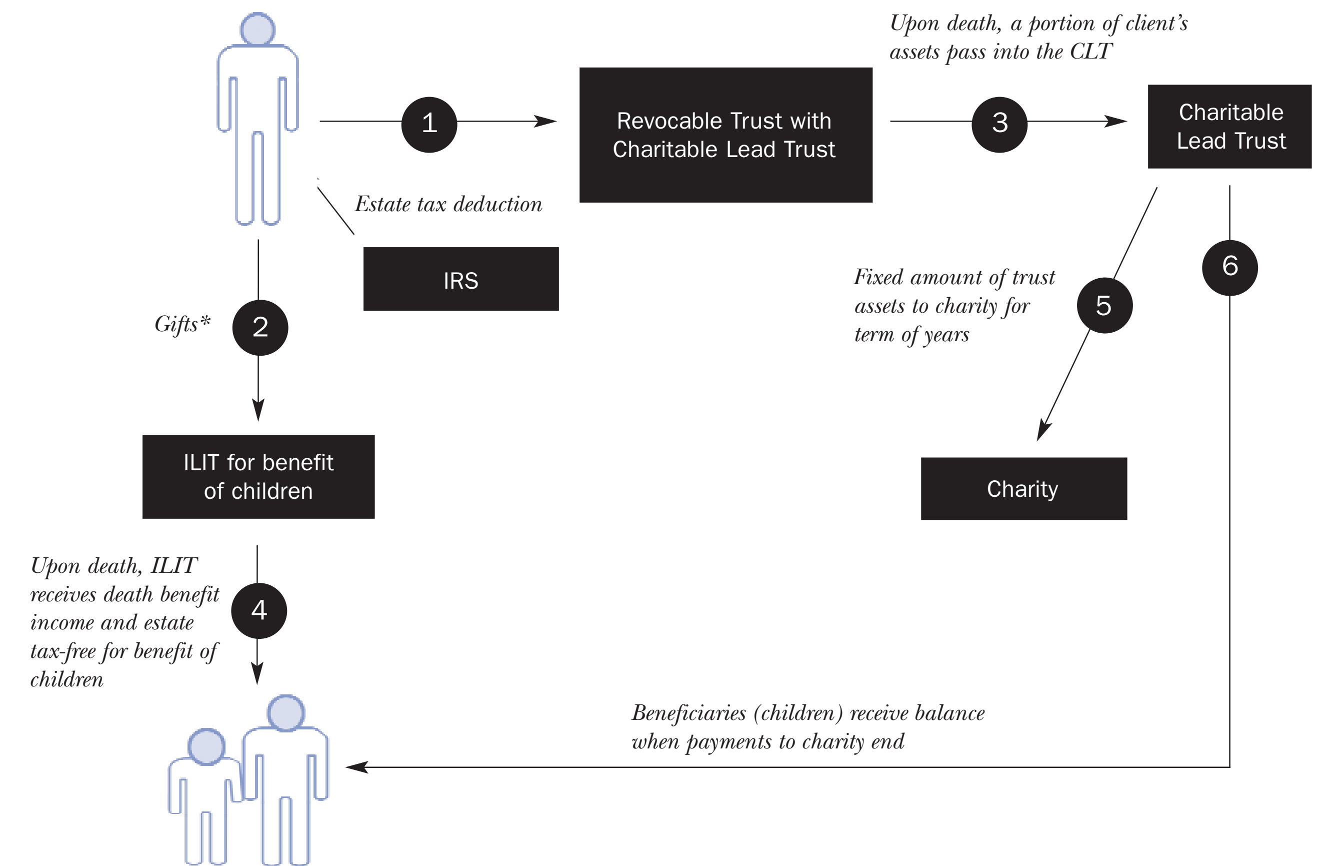
Life insurance can be a fitting complement to a charitable lead trust because, although the charitable lead trust reduces the estate tax exposure, it gives to the charity some of what the children would have received and the children must wait a fair amount of time before receiving the remaining balance. By purchasing a life insurance policy within an Irrevocable Life Insurance Trust (ILIT), clients may be able to replace the wealth lost to the charity under the lead trust with the life insurance death benefit. There may be gift tax consequences associated with the funding of an ILIT. Properly owned within an Irrevocable Life Insurance Trust, the death benefit should be received by the ILIT federal income and estate tax-free and distributed to the trust beneficiaries in accordance with the terms of the trust documents.

Client Profile

- Age 65+
- Charitably inclined
- Significant estate tax exposure
- Would like to enhance value of wealth that passes to next generation

How it Works:

1. Client creates a testamentary charitable lead trust (CLT).
2. Client creates Irrevocable Life Insurance Trust (ILIT), which purchases life insurance on the lives of the clients using gifts from the clients.*
3. Upon the death of the clients, a portion of their assets pass to the charitable lead trust. As a result, the client's estate receives a federal estate tax deduction income and estate tax-free.
4. The trustee of the ILIT collects the insurance proceeds income and estate tax-free to replace the assets passing to the charitable lead trust and distributes them to the children according to the terms of the trust.
5. For a specified term of years, the trustee of the charitable lead trust distributes a fixed amount of the charitable lead trust assets to the named charity.
6. Upon the expiration of the term of years, the remaining balance of the CLT assets are distributed to the children.



*There may be federal gift tax consequences associated with the funding of an ILIT.

ADVANCED ESTATE PLANNING

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