Dynasty Trust with Life Insurance

Situation

John, 78, and Susan, 80, are successful, retired and currently worth $23.5 million, $8 million of which is in municipal bonds. They maintain a moderate lifestyle and are not consuming all their income. They are making annual exclusion gifts to their two children and their spouses, as well as to their five grandchildren.[1] A portion of the monies are funding a $4 million survivorship policy in an irrevocable life insurance trust. They plan to continue making cash gifts.

John and Susan are very conservative and like the idea of using life insurance as an asset class. They have also indicated that they would like to each use $1 million of their lifetime gift tax exemptions.[2] John and Susan don't like complex strategies and are looking for an uncomplicated recommendation.

Recommendation

Gift $2 million of their lifetime gift tax exemptions to a dynasty trust,[3] applying $1 million each of their generation-skipping transfer tax exemption.[4]

A dynasty trust is an irrevocable trust that is designed to leverage estate, gift and generation-skipping transfer tax exemptions by allowing trust assets and future appreciation thereon to remain free from transfer taxes for as many generations as state law permits.[5] Once the original transfer of assets to the dynasty trust is accomplished, the trust assets, accumulated income and appreciation remain free of federal estate and gift taxes for the term of the trust.

The trustee purchases a single premium survivorship policy on John and Susan, who are both preferred nonsmokers, in the amount of $6,097,511, which is guaranteed to John's age 100.[6, 7]

Potential Benefit

Using a dynasty trust with life insurance increases the amount of wealth John and Susan are able to transfer to future generations.

[1] Under Internal Revenue Code (IRC) §2503(b), the gift tax annual exclusion amount is $13,000 per recipient per year (2011) and $26,000 per year if a married couple splits their gifts under IRC §2513(a).

[2] The gift tax applicable credit amount is equal to $1,730,800 (2011), which translates into a gift tax lifetime exemption of $5 million per individual.

[3] Trusts should be drafted by an attorney familiar with such matters in order to take into account income and estate tax laws (including generation-skipping tax). Failure to do so could result in adverse tax treatment of trust proceeds.

[4] A generation-skipping transfer tax (GSTT) is imposed on transfers that "skip" at least one generation and is imposed in addition to any estate or gift tax due on the transfer. Each individual has a cumulative exemption from the GSTT, which may be used during lifetime or death. In 2011 and 2012, the GSTT exemption amount is $5,000,000 per individual.

[5] In some states the trust must terminate and distribute all funds within 21 years of the death of the last individual alive at the time of the trust's creation. There are, however, a number of states that allow trusts to continue in perpetuity, or a number of years in excess of 90, covering multiple generations, with no estate taxes.

[6] The use of a lump sum premium payment to utilize all or a portion of a transferor's lifetime gifting exemption or generation-skipping transfer tax exemption may cause the life insurance contract, as classified under Internal Revenue Code (IRC) §7702, to be classified under IRC §7702A as a modified endowment contract (MEC). For death benefit purposes, a MEC is treated in the exact same manner as a life insurance contract so that death benefit proceeds are 100 percent exempt from federal income taxation.

[7] Guaranteed death benefits are subject to the claims-paying ability of the insurance carrier.

[8] Assumes estate tax exemption of $3,500,000 and 45 percent marginal estate tax rate.

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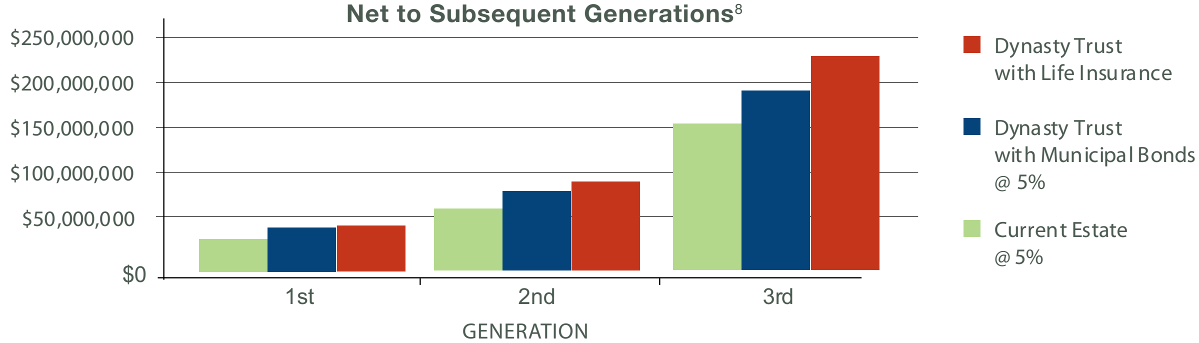
NET TO HEIRS			
	Current Estate @ 5%	**Dynasty Trust with Municipal Bonds @ 5%**	**Dynasty Trust with Life Insurance**
Estate – Yr. 14 First Generation	$42,274,121	$39,529,764	$39,529,764
Estate Taxes	($17,448,354)	($16,663,394)	($16,663,394)
Credit Shelter Trust of First to Die	$4,051,688	$2,894,063	$2,894,063
Dynasty Trust	0	$3,959,863	$6,097,511
Net to Children – Yr. 14	$28,877,455	$29,720,296	$31,857,944
Increase Over Current		**$842,841**	**$2,980,489**
Estate & Dynasty Trust – Yr. 39 Second Generation	$93,132,675	$95,850,924	$102,745,052
Estate Taxes	($39,348,555)	($34,462,739)	($34,118,033)
Net to Grandchildren – Yr. 39	$53,784,120	$61,388,185	$68,629,019
Increase Over Current		**$7,604,065**	**$14,842,899**
Estate & Dynasty Trust – Yr. 73 Third Generation	$269,092,092	$307,136,663	$343,353,915
Estate Taxes	($113,691,409)	($98,065,089)	($96,254,226)
Net to Great-grandchildren – Yr. 73	$155,400,683	$209,071,574	$247,099,689
Increase Over Current[8]		**$53,670,891**	**$91,699,066**

NET TO HEIRS ANALYSIS			
Generation	**Current Estate at 5%**	**Dynasty Trust with Municipal Bonds @ 5%**	**Dynasty Trust with Life Insurance**
1st	$28,877,455	$29,720,296	$31,857,944
2nd	$53,764,120	$61,388,185	$68,629,019
3rd	$155,400,683	$209,071,574	$247,099,689

Net to Subsequent Generations[8]



Before establishing an ILIT one should consider the cost of creating and maintaining the ILIT, that life insurance qualifications generally require medical and financial underwriting, the desired policy premium may be higher than your gift tax exclusion or lifetime exemption, gifts in excess of these exclusions and exemptions will be taxable, and that transfers to an ILIT are irrevocable.ILIT assets may be insufficient to pay the premiums. In certain situations additional out of pocket contributions to the ILIT may be required to maintain the desired level of insurance.

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