Zero Estate Tax Plan with Life Insurance

Situation

James, 65, and Jeri, 62, are retired and have built a significant estate of $14 million. They are not currently making annual exclusion gifts to their four children.[1] They would like to leave their children the amount they can pass transfer tax-free, which under current law is $10 million. Because they are active in their community and regularly support various charities, they would like any funds in excess of this amount to benefit charity — not the IRS. After their death, James and Jeri would ideally like their children to continue their philanthropic activities. They are looking for a recommendation that provides flexibility and accomplishes their philanthropic and wealth transfer goals.

A Recommendation

Implement a zero estate tax plan that:

- Fully utilizes the couple's combined estate tax exemptions and the unlimited marital deduction
- Provides the surviving spouse access to the entire estate during his or her lifetime
- Fully utilizes the estate tax charitable deduction at the second death by passing the portion of the estate that exceeds the couple's combined estate tax exemptions to a private family foundation or a donor advised fund — estate tax-free
- Allocates a portion of their estate to an irrevocable life insurance trust (ILIT) through the use of annual exclusion gifts to acquire a survivorship life insurance policy that enhances the amount of wealth transferred to their family
- Ensures the amount and recipient of the charitable bequest, if any, can be changed at anytime before the second death

Footnote

[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).

Potential Benefit

As demonstrated below in Option 1, by gifting $520,000 ($52,000 per year for 10 years) to an ILIT funded with a $2.6 million second-to-die life insurance policy, it is possible to leave their children $12.6 million while leaving charity approximately $2.7 million.[2]

By increasing the gifting to $1,040,000 ($104,000 per year for 10 years), as demonstrated in Option 2, they are able to increase the amount of wealth transferred to their family by $2.6 million and the charity receives approximately $2.96 million. In all scenarios, the unlimited charitable estate tax deduction eliminates any potential estate tax liability. By implementing Option 2, James and Jeri increased the amount of wealth transferred to family and charity by 44 percent.[3]

If a private family foundation is the charity, the couple's children will manage the foundation and can receive reasonable compensation from the foundation. If a donor advised fund is used as the charity, the children will make recommendations concerning distributions/grants from the fund.

	Current Plan	Zero Estate Tax Plan with Life Insurance Option 1	Zero Estate Tax Plan with Life Insurance Option 2
Beginning Estate	$14,000,000	$14,000,000	$14,000,000
Less: 10 Pay Life Insurance Premium	0	520,000	1,040,000
Gross Estate for Estate Tax Calculation	$14,000,000	$13,480,000	$12,960,000
Applicable Credit	$10,000,000	$10,000,000	$10,000,000
Charitable Deduction	0	$3,480,000	$2,960,000
Taxable Estate	$4,000,000	0	0
Estate Tax	$1,400,000	0	0
Life Insurance	0	$2,600,000	$5,200,000
Total to IRS	$1,400,000	0	0
Total to Family	$12,600,000	$12,600,000	$15,200,000
Total to Charity	0	$3,480,000	$2,960,000
Total Wealth Transferred	$12,600,000	$16,080,000	$18,160,000
Increase		$3,480,000	$5,560,000
% Increase over Current		28%	44%

Footnotes

[2] All guarantees are subject to the claims-paying ability of the issuing insurance company. Discussion addresses fixed insurance only. The hypothetical case study results are for illustrative purposes only and should not be deemed a representation of past or future results. This example does not represent any specific product, nor does it reflect sales charges or other expenses that may be required for some investments. No representation is made as to the accurateness of the analysis.

[3] For simplicity, the hypothetical case study assumes: no growth or depletion of their estate other than that attributable to gifts made to ILIT equal to amount of life insurance premiums; deaths occur after year 10; each spouse fully utilizes their applicable credit amounts; and 35 percent estate tax rate.