Life Insurance in Estate Planning

COLTON GROOME INSURANCE ADVISORS

Why Use Life Insurance in Estate Planning?

Life insurance is a cost-effective way to provide liquidity for taxable estates to pay for the 40% estate tax that is due withing 9 months of death. Ownership of the policy in an Irrevocable Life Insurance Trust (ILIT) avoids inclusion of the income tax free death benefit in the taxable estate. Use as a liquidity tool may be what most planners think of when it comes to life insurance. However, such a myopic view ignores numerous other ways life insurance owned outside of the taxable estate may be valuable.

Professional Management and Asset Protection

Life insurance owned in an ILIT may provide resources for the family that are protected from creditors which is very important in a litigious society. The assets will also be professionally managed by a trustee with a fiduciary obligation to the trust beneficiaries.

Hedge Position

The estate tax due at death and the liquid resources available to pay the tax is impossible to accurately predict. It will be a function of the growth of the estate over time, estate tax laws at the time of death, estate composition at death, whether planning techniques are executed, and the valuation of assets at the time of death. Life insurance death benefit as part of an estate plan provides a pool of cash to help offset increases in tax liabilities or shortfalls in liquidity.

Estate Equalization

Estates are often comprised largely of a privately held business, and some adult children won't be involved in the business. Rather than forcing a child actively involved in the business to have uninvolved siblings become partners through acquisition of business ownership interests when the estate is settled, life insurance can be used to provide an equivalent inheritance to the children who aren't involved in the business. This maintains the business decision making and direction with the children who best understand the business.

Blended Families

It is common for families to have children from prior partners as well as the current partner. Life insurance is often used to provide an inheritance to children from a different relationship without giving the estate assets (i.e., the business) to them.

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Baseline Inheritance Amount

Life insurance proceeds may be used to provide a minimum amount of inheritance to beneficiaries regardless of the value of the estate. This provides peace of mind that you can enjoy your wealth as you choose without worrying about your actions impacting your legacy to your children.

Asset Class

Life insurance provides a stated minimum benefit. It is often viewed as a unique asset class - an income tax free alternative to taxable bond portfolios. The stable value of the asset can be integrated into overall asset planning, and the liquidity at death may allow the estate to engage in investments with liquidity restrictions or longer time horizons that would otherwise be practical.

Leverage Gifts

Life insurance can be a great way to leverage premium gifts into larger values or to leverage assets in existing generational trusts into a larger pool of money over time without generating income tax.

Offset Wealth Depleted by Division and Taxation

Federal and state estate taxes can diminish 40%+ of your wealth passed to your family. In addition, divorce or lawsuits can reduce the estate. Wealth gets diluted over time simply as it is split across children at each generation. $100M of family wealth can drop to $9M of wealth per child after dilution and taxes in only 2 generations of 2 children each. Life insurance can be used to replenish family wealth lost to tax or division of assets.

Strategic Family Support Asset

Life insurance held in trust may be used to provide access to policy cash value on a tax-free basis or to provide an income tax free death benefit. This can allow family members to have accessible funds on favorable terms for new business ventures, building a house, funding education, supporting a family retreat, funding a family office, or other endeavors. Each generation can replenish the asset pool through life insurance. Life insurance may also be protected from creditors in some states.

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