Leveraging Annual Exclusion Gifts with Life Insurance

Mama Leone is a 68-year-old widow; she and her husband were successful restaurateurs and owned a number of commercial properties. She is in good health and has five children and 11 grandchildren. Her overall estate is worth $25 million.

HOW GIFTING WITH LIFE INSURANCE WORKS

Mama Leone's attorney has advised her to start making gifts to reduce her estate. He recommends that she set up an irrevocable trust and fund it with Crummey gifts. With 16 potential Crummey beneficiaries, Mama Leone's gifting budget is $224,000 per year (16 x $14,000). By using annual exclusion gifts, Mama Leone won't have to dip into her lifetime gift tax exclusion. She will, however, apply her federal generation-skipping transfer (GST) exemption to each Crummey gift so that her trust can be a dynasty trust.

Mama Leone's attorney also recommends that she apply her gift budget toward the purchase of a policy on her life to provide estate tax liquidity upon her death. In her case, an annual premium of $224,000 will purchase a policy with a death benefit of approximately $10.2 million.

Upon Mama Leone's death, the trust will receive the insurance death benefit free of income and transfer taxes. The $10.2 million death benefit will be invested in the trust for the benefit of the children, grandchildren and Mama Leone's future descendants.

As is shown in the following chart, making gifts to an irrevocable trust is a powerful way to leverage the benefit of those transfers. If Mama Leone chooses not to make the suggested gifts, at her life expectancy, she'll leave approximately $28 million to her heirs. If Mama Leone decides to purchase the life insurance policy but doesn't want to make gifts to a trust, then the net she'd leave to her heirs would be increased by $6 million to $34 million.

What if the Mama Leone chose to make the gift to the trust but didn't want to purchase life insurance? In that instance, her heirs would inherit $30.5 million, which is $23.9 million from Mama Leone's taxable estate and $6.6 million from the trust. And if Mama Leone decides to both make the gift to the trust and purchase life insurance, then the net she would leave to her heirs would be approximately $34 million, or 22.27 percent greater.

Year	Age	Net to Heirs No Planning*	Net to Heirs Gifting*	Increase over No Planning	Net to Heirs Gifting with Insurance	Increase over No Planning
1	69	$15,450,000	$15,542,288	0.60%	$25,494,953	65.02%
5	73	17,389,111	17,879,081	2.82%	26,837,542	54.34%
10	78	20,158,746	21,216,724	5.25%	28,755,163	42.64%
15	83	23,369,511	25,085,968	7.34%	30,978,211	32.56%
21 (L.E.)	89	27,904,419	30,550,914	9.48%	34,118,060	22.27%

*Assets not invested in insurance are assumed to grow at 3 percent net.

BENEFITS OF GIFTING WITH LIFE INSURANCE

- Life insurance provides valuable estate liquidity at death.
- Assets inside the trust are protected from the reach of creditors, providing asset protection for the family.
- Any assets gifted to the trust can be leveraged free of gift, estate and GST taxes.
- The policy death benefit is received by the trust free of income and estate taxes.
- The trust can be structured to be a dynasty trust, with all trust assets exempt from the federal GST tax.

CONSIDERATIONS OF GIFTING WITH LIFE INSURANCE

- Donor loses access to the assets transferred to the trust.
- There are annual trust administration and gift tax return costs.
- Trust must be carefully drafted to provide for Crummey gifts, proper allocation GST exemption and asset protection.

THE BOTTOM LINE

Maximizing annual exclusion gifts with the purchase of life insurance in an irrevocable trust significantly increases the amount of wealth received by a donor's heirs free of income and transfer taxes. And if the trust is structured as a dynasty trust, the donor can provide a legacy for future descendants.

Contact the Partners Financial Advanced Sales team or your Business Development contact for more information.

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