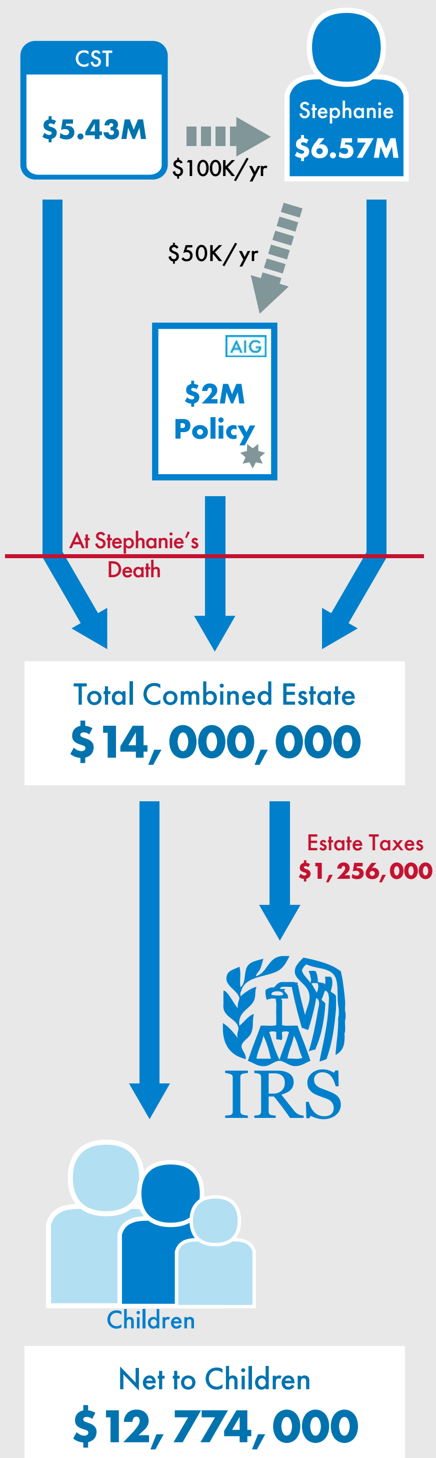
What if...

... there is a way for a widow(er) to buy life insurance without increasing estate taxes?

Current Plan



Background:

Stephanie and Patrick owned a portfolio of managed real estate, which provided their retirement income. With an estate valued at $12M, they engaged in the most basic estate planning, putting a Credit Shelter Trust (CST) in place – to be funded at the first death. This kind of trust – also known as a B-Trust or a Bypass Trust – would shelter over $5M from estate taxation and provide other benefits.

Patrick died in 2015 and the trust was funded with assets equaling $5,430,000 – the amount exempt from Federal estate taxes in that year. The trust is set up to provide a $100K/year income to Stephanie during her life, if she needs it, and then transfer the assets to their children at her death.

At Patrick's death, the balance of the estate (approximately $6.6M) passed to Stephanie and she intends to leave all of it to the children at her death.

The Problem:

After meeting with her financial professional and accountant, Stephanie realizes that her estate faces sizeable federal estate taxes at her death. The tax bill is almost $500K this year, growing to over $2.5M in the next twenty years.

Since most of the estate is not liquid, Stephanie (now age 70) decides to purchase $2M of life insurance to provide the liquidity to pay estate taxes and other potential expenses at her death. The premium is approximately $50K per year.

Her financial professional informs her that, if she purchases the insurance herself, the personally-owned insurance will be subject to additional estate taxes – representing an $800,000 loss to the children (at a 40% estate tax rate).

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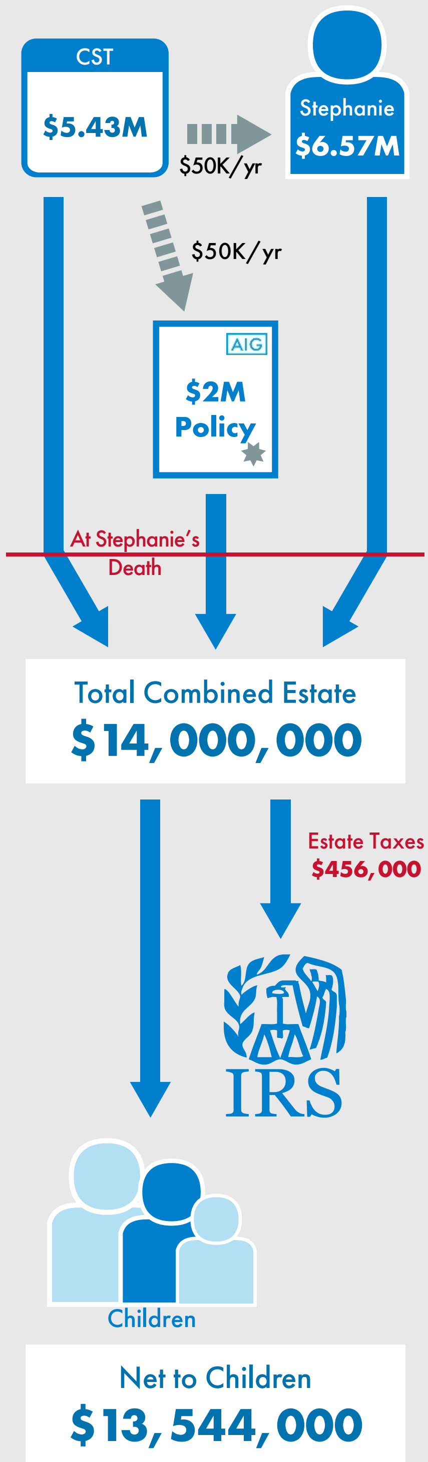
How can she buy life insurance without making the situation worse?

Proposed Plan



The Solution:

For many wishing to avoid estate taxes on insurance benefits, the solution is to set up an Irrevocable Life Insurance Trust (ILIT). These trusts effectively own the life insurance outside of the estate and are, therefore, not subject to estate taxes at death.

There are drawbacks to ILITs, however. First, there are costs to setting one up. Second, the premiums are, typically, gifted to the trust by the insured. Finally, the trust requires annual administration, so a trustee (and the inherent expense) is necessary.

But, for Stephanie, a simple solution may be right in front of her – Patrick's Credit Shelter Trust. This trust is already outside of Stephanie's estate.

How will the premiums be paid? Stephanie decides that rather than receive the full $100K from the trust, she will forego $50K of it, enabling the trust to use that money to pay the premiums.

There will be no impact on Stephanie's cash flow, but the increased benefits to the children will be substantial – and the IRS will not get a piece of the insurance benefits. The table, below, summarizes the results.

	CURRENT Stephanie Buys Insurance	PROPOSED CST Buys Insurance
	CST Values (Outside the Estate)	
CST Initial Value	$ 5,430,000	$ 5,430,000
Life Insurance in Trust		$ 2,000,000
To Children	$ 5,430,000	$ 7,430,000
	Stephanie's Estate Values	
Initial Value	$ 6,570,000	$ 6,570,000
Life Insurance in Estate	$ 2,000,000	
Estate Tax	$ (1,256,000)	$ (456,000)
To Children	$ 7,314,000	$ 6,114,000
	Results	
Total to Children	$ 12,744,000	$ 13,544,000
Additional Amount to Children		**$ 800,000**

By simply using the existing Credit Shelter Trust to buy the life insurance, Stephanie will reduce the estate tax bill by $800,000 – money that will now go to the children rather than the IRS.