17 Overlooked Uses for Life Insurance

Leverage

Optionality / Flexibility

Certainty / Liquidity

Attractive Risk-Adjusted IRRs – multi-decade compounding

Highly Tax-Advantaged

Basis Step-Up AND outside taxable estate

Observations:

- Much of client balance sheets are comprised of illiquid assets.
- Even with financial portfolio assets, how do they know whether they're going to die in an up or down market?
- Many constructive uses for life insurance in estate planning, yet much (most) of estate planning today is <u>not</u> about the Federal estate tax. Income tax planning is the new estate tax planning.
- Fewer clients are subject to federal estate taxes due to the size of the estate tax exemption and 'portability.' Some believe a Republican President and Republican-controlled Congress may seek estate tax repeal. Yet many Republicans privately would prefer not to use political and policy capital on an issue which has been largely "solved." Even if repealed, the estate tax would likely come back with (an inevitable) change of control in Congress; further, given their position on the issue, Democrats may well support a lower exemption and higher tax rate than current law. There has been a Federal Estate Tax for 99 of the last 100 years, and considering all the factors and economic realities, any form of "permanent repeal" appears highly improbable.

1. **Estate Equalization** – balancing specific bequests
    a. Real estate or a business may be difficult / ill –advised to split among heirs
    b. All kids don't always get along;
    c. Even minority interests can forced a partitioned sale.

2. **Charitable Remainder Trusts**
    a. Wealth Replacement Trust – replacing remainder interest going to charity

3. **Avoiding World War III**
    a. Children from previous marriage – **QTIP Trust is a wrong answer** – kids may be trustee and remainderman, waiting for step mom to die; separate life policy for the kids can let wife have a trust to herself
    b. Life insurance can also serve as **an incentive not to contest** surviving step mom's power of appointment changes, etc.

4. Special Needs Beneficiaries
    a. With life insurance, don't have to rely on time to grow the asset – guaranteed to be there from the outset.
    b. Structure so as not to disqualify beneficiary from government benefits, or be clawed back by governmental payor.

5. **Provide a head start for grandkids via funding a college education**
    a. Life insurance allows for a direct gift to the grandkid, who knows where it came from.
    b. Insurance can fund a "family trust bank" – basic ILIT allowing trustee to make discretionary distributions for college, buying a home, starting a career, etc.

6. **For real estate entrepreneurs – money in a "family bank" can:**
    a. Provide the liquidity needed to pay death taxes in lieu of liquidating any real estate; or
    b. Finance the acquisition of additional properties after patriarch is gone.
    c. Death of principal can trigger a technical loan (covenant) default making loan callable.

7. **Life Insurance helps stabilize the legacy:**
    a. By making up market-driven losses in a stock portfolio or retirement plan;
    b. Reimburse estate for taxes paid to effect a Roth conversion.
    c. **Pay tax toll on a post-death Roth IRA conversion**
    d. Help facilitate a Stretch IRA for non-spouse beneficiaries

8. **In connection with a Dynastic IRA (super stretch, w/ IRA going to grandkids having longer life expectance than decedent's children**
    a. Applicable to DC plan balance also, as they can be rolled into an IRA
    b. Life insurance goes to children in compensation for IRA going to grandchildren;
    c. Can use a restricted beneficiary payout / form allowing "control from the grave"
        i. Annuity products can accommodate this well
        ii. Beneficiary gets RMD only – maybe a little more
        iii. Future, all-in value of an account can be 4 – 6 times DOD value
        iv. Consider a IRA Inheritance Trust as the beneficiary
            1. Facilitates stretch and provides asset protection (divorce, lawsuits, creditors, etc.)
    d. Super-leveraged IRA – life insurance in ILIT used to pay tax on IRA withdrawals

9. **IRA rescue – strip out the "bottom money" (portion of IRA account which isn't needed and will never be used)**
    a. Strip that portion, pay taxes on it, and use remainder to buy an immediate annuity to fund life insurance premiums – economics can often beat those of a Roth conversion.

10. **Super leveraged B Trust**
    a. Even w/ portability, still reasons to set up B Trust;
    b. Life insurance on the surviving spouse is funded by B Trust assets not needed

by surviving spouse – causing the B Trust to function much as its own ILIT.

11. **Have client's private foundation buy life insurance on the original donor (with or without immediate annuity to fund premiums)**
    a. At death, funds or enhances the family foundation;
    b. Life insurance bought with tax deductible dollars, since contributions to the family foundation are deductible (likely limited to 20% of AGI);
    c. At death, part of foundation corpus is used to buy life insurance on original donor's children; initial DB may be $500,000, then $5MM, then $20MM with grandchildren generation.

12. **Life insurance can serve as IRS audit insurance.**

13. **Life insurance can perform double duty by assisting in premortem morbidity planning.**
    a. Can provide income tax-free liquidity to cover a long-term care need. To the extent such a peril has been addressed, client has more latitude in designing & funding dispositive provisions for death

14. **For larger estates using QPRTs, GRATs, or installment notes, grantor must survive for the term or asset comes back into taxable estate.**
    a. Term life insurance can cover this possibility.

15. **Life insurance can dramatically expand the tax deduction to a DB Pension plan.**

16. **In connection w/ muni bond portfolios**
    a. Sell the bonds, pay cap gains tax if any, use net proceeds to buy an immediate annuity to fund ILIT-owned life insurance to (i) replace the value of the bond portfolio AND STILL (ii) keep Grantor's after-tax income at parity with that provided by the municipals. Value of the bond portfolio is now outside rather than inside the taxable estate.

17. **To replace the loss of the first spouse to die's SS benefit**

    Two spouses with a Social Security earnings record enjoy two social security incomes. Upon death of the first to pass, one income is lost – the smaller of the two. A life insurance death benefit can replace the lost income to the survivor – possibly via a **reversionary annuity** (life insurance where the death benefit is received as a lifetime income stream to the survivor.)

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