Framing Your Legacy

With Transfer Tax Certainty, It Is Time to Consider Your Estate And Life Insurance Planning

MKT13-65

Framing Your Legacy

New Laws Create a Framework

After many years of transfer tax "shifts," Congress enacted the American Taxpayer Relief Act of 2012 (ATRA). ATRA provides you a framework from which to plan by permanently* setting the federal estate, gift and generation skipping transfer (GST) tax exemption limits.

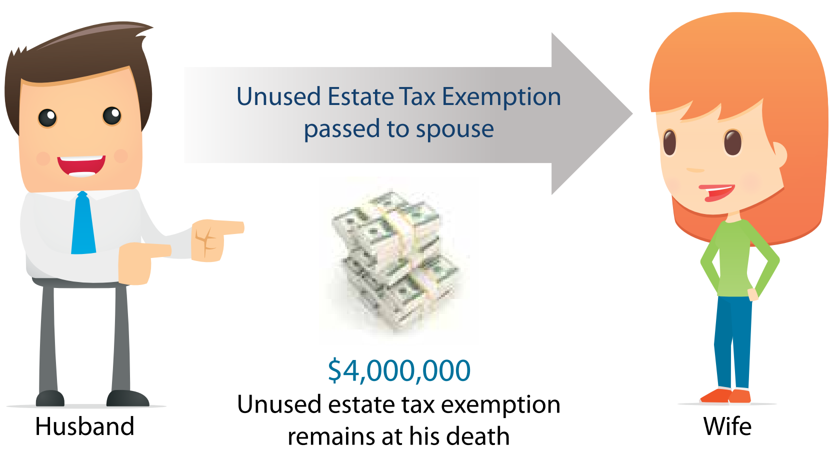
Federal Tax Exemption Amounts**	Maximum Transfer Tax Rate
• $5,000,000 per individual • $10,000,000 per married couple	• 40% applied to estate, gift & GST tax

** *Indexed for inflation (effective for tax years after 2011). For example, in 2012 and 2013 the exemption amount increased to $5.12 million and $5.25 million (respectively). For the most recent figures on the exemption amount, please consult with your tax and legal advisor.*

Permanent Portability

ATRA also made permanent the portability of the unused estate tax exemption amount between a married couple. Portability enables the first-to-die spouse to "pass on" his or her unused estate tax exemption amount to the surviving spouse. For portability to apply, the executor of the first-to-die spouse's estate must elect portability by filing an estate tax return with the Internal Revenue Service (IRS). It should be noted that the deceased spouse's unused exemption amount is indexed for inflation. However, the unused exemption amount is "fixed" as of the date of the deceased spouse's death (i.e, the exemption amount is not indexed for inflation after the deceased's spouse's death). Additionally, there is no portability for purposes of the GST tax.

A hypothetical example:



Her estate tax exemption:	$5,000,000
His "portable" estate tax exemption:	+$4,000,000
Total estate tax exemption available for wife:	**$9,000,000**

Portability means the tax exemption may not be lost at the 1st death!

* *Please note that even though ATRA provides "permanent" legislation, "permanent" is a relative term in connection with tax laws. There may be future legislation that changes or revises the current tax laws. Please consult with your legal and/or tax advisors.*

Endnotes on page 18.

Where to Start

Working within ATRA's framework, here are 3 key questions to discuss with your legal, tax and financial advisors, and life insurance producers:

1 Which of these planning tools do you already have in place?

- ☐ **Basic Will**
- ☐ **Durable Power of Attorney for Assets**
- ☐ **Durable Power of Attorney for Healthcare**
- ☐ **Guardian Instructions**

To learn more, go to page 4.

2 In which category does your estate's value currently fit?

The size of your estate will determine if federal "transfer tax" planning needs to be part of your estate's strategy.

To learn more, go to page 5 and page 7.

3 What do you want to happen with your estate? What are your goals?

Your goals will help determine which planning techniques when combined with life insurance will help you accomplish your legacy goals.

On pages 6 and 8 we have provided you some questions to consider to help with your goals.

Lay a Foundation

Regardless of your wealth or the size of your estate – basic estate planning is necessary for almost everyone. There are four cornerstones to any legacy plan:

1. **A will**
2. **A durable power of attorney for assets**
3. **A durable power of attorney for healthcare (or its equivalent)**
4. **Guardianship instructions**

Ask:

- What assets do I own?
- How do I want my assets transferred at death?
- Who will get what?
- Do I want the government to decide who gets what or do I want to have control over the disposition of my hard earned wealth?
- Who will make financial decisions on my behalf if I am incapacitated?
- Who will make medical decisions on my behalf if I am unable to do so?
- Who will take care of my minor children if I can't do so?

To Give it Away at Death or Not?

With the higher federal estate tax exemption amount and the "step-up" cost basis rules, it may be advantageous to personally own assets at your death. "Capital gain" assets that are owned by you at your death receive a step-up in cost basis to the asset's current fair market value. If the asset is transferred prior to your death, the asset may not be eligible for a step-up in cost basis. If you have substantial low-cost basis assets, it may make sense to retain ownership of these assets until death in order to minimize the impact of capital gains tax if the asset is later sold by your heirs.

The Basic Will

A will is a legal document that expresses an individual's wishes regarding the disposition of his or her property after death. A will is generally revocable and amendable until death and only becomes effective upon death. By preparing a will, an individual is able to control the passing of his or her property on his or her terms. Without a will, state law will dictate to whom a decedent's property will pass.[1] Each state has its own laws as to what requirements are necessary for a will to be valid. Before executing a will, check with local counsel to determine what the requirements are. An improperly executed will is likely to be declared invalid and not be recognized by the local probate court. ***Note:*** *Wills may be drafted to include more sophisticated planning tools, such as A/B provisions that utilize the remaining estate tax exemption of the first spouse to die. This is discussed in further detail below.*

Durable Power of Attorney for Assets

A durable power of attorney for assets (DPOA) is used to nominate someone to make financial decisions for the principal. The purpose of a DPOA is to ensure someone is always available to make financial decisions in case of incapacity. A DPOA will be needed for any property not transferred to a living trust because property transferred to a living trust can be managed by the trustee. A DPOA is very flexible, easy to create and involves little cost. A DPOA is revocable by the principal. It can be drafted broadly or on a very limited basis.[2]

Durable Power of Attorney for Healthcare

A durable power of attorney for healthcare (DPAH) is used to nominate someone to make healthcare decisions for the principal. The DPAH gives this person the authority to determine which medical treatment to consider should the principal become incapacitated. Most states have statutes that authorize the appointment of a health care agent. A DPAH is easy to create and is revocable. The decision of whom to nominate should not be taken lightly because, if the DPAH is ever used, it will be a very difficult time for all those involved.

Build Your Estate Plan to Help Meet your Goals

If this is you…

Less than Federal tax exemption

99% of Americans are estimated to fall in this category.

According to some experts, ATRA eliminates the federal estate tax for about 99% of the population.[3] And, given that the federal estate tax exemption amount is indexed for inflation (and will likely continue to increase over time), most taxpayers may continue to avoid the federal estate tax. Keep in mind, however, that even though your estate may not be subject to federal estate taxes, you and you heirs may still benefit from estate and life insurance planning.

Ask:

- Will my spouse or partner be financially secure when I die?
- How can I make sure my children are provided for? What about my children from my prior marriage – how can I make sure they are properly provided for? How can I ensure that all my children are treated equitably?
- Are there certain debts or loans that I want paid off at my death so that my family is not burdened with these expenses? What will my funeral expenses be and how will my family pay for those?
- Do I have a business I want to pass on to my loved ones when I die? Will the business that I built from scratch stay in my family?
- Will my favorite charities be financially burdened at my death? How can I help to minimize this?
- Does my state have state death taxes? If so, how will my estate pay for those state taxes?

Estate and Life Insurance Planning Fundamentals

This category of strategies may be useful for everyone to consider. It focuses on ways to assist in attaining your family, business and charitable planning goals and less on transfer tax planning. Find your primary goal and the associated strategy to consider.

My Primary Goals	Strategies to Consider	Page No.
You are concerned about the impact of state death taxes on your planning	• Life Insurance for State Estate Tax Planning	9
You want to make sure your assets pass efficiently (and privately) to your loved ones while minimizing probate expenses.	• Revocable Living Trust	9
You want to transfer your business to family members active in the business without disinheriting those who are not.	• Family Buy-Sell • Wealth Equalization Using Life Insurance	10 10
You want to provide for your current spouse/ partner and for your children from a prior marriage/relationship.	• Life Insurance for the Blended Family or Unmarried Couples • Wealth Equalization Using Life Insurance	9 10
You are concerned that market volatility will adversely affect your assets and leave a smaller inheritance for your heirs.	• Wealth Stabilization Using Life Insurance	10
You want to ensure your loved ones are treated equitably.	• Wealth Equalization Using Life Insurance	10
You have a history of giving to a particular charity (or charities) and want to ensure the gifts continue should you die prematurely.	• Charitable Gifts of Life Insurance	10
You want to transfer wealth to a particular charity (or charities) but do not want to disinherit your heirs.	• Wealth Replacement Trust Using Life Insurance	11

Frame Your Estate Plan to Fit Your Needs – Federal Estate Transfer Costs + Your Goals

If this is you…

Value is **More** than Federal tax exemption

Only 1% of Americans will fall in this category.[3]

Ask:

- What are my goals for my estate? What legacy will I leave to my heirs?
- What will be the impact of transfer taxes on my estate?
- How will the transfer taxes due affect what I want to leave my family?
- How do I want to provide for my spouse?
- How do I want to provide for my children and grandchildren?
- Are there certain debts or loans that I want paid off at my death so my family is not burdened with these expenses? What will my funeral expenses be and how will my family pay for those?
- Do I have a business I want to pass on to my loved ones when I die? Will the business that I built from scratch stay in my family?
- Will my favorite charities be financially burdened at my death? How can I help to minimize this?
- Does my state have state death taxes?

Tools to Consider to Help Minimize Federal Transfer Taxes and to Transfer Wealth to the Future Generations.

These strategies focus on the dual goals of minimizing federal transfer taxes and wealth transfer to future generations. Find your primary goal and consider the corresponding strategy.

My Primary Goals	Strategies to Consider	Page No.
You want to make simple gifts to your loved ones without utilizing your gift tax exemption amount or reducing your remaining estate tax exemption at death.	• Annual gifting program	11
You want to utilize the remaining estate tax exemption amount at the death of the first spouse and minimize estate taxes at the death of the surviving spouse.	• Marital or B-Trust Planning with a Will or Living Trust	12
You have concerns over federal estate taxes and would like to remove existing life insurance policies from your estate or purchase new life insurance policies (i.e., to provide estate tax liquidity) outside of your estate	• Irrevocable Life Insurance Trust	13
You want to purchase life insurance in a trust to address estate taxes but are concerned about losing access and control over the potential life insurance policy cash value.	• Spousal Lifetime Access Trust	13
You want to create a trust for the benefit of your children, grandchildren, and future generations.	• Dynasty Trust (Generation Skipping Trust)	13
You have concerns over the federal estate tax and want to maximize the wealth transferred to your heirs by using strategies that reduce the gift tax value.	• Grantor Retained Annuity Trust • Sale to an Intentionally Defective Irrevocable Trust • Family Limited Partnership	14 15 16
You have a primary or secondary residence that you would like to remove from your estate while making the most of your gift tax exemption.	• Qualified Personal Residence Trust	14
You want to provide for your favorite charity while also retaining an income stream and benefitting your loved ones.	• Charitable Remainder Trust with a Wealth Replacement Trust	16
You need life insurance protection for estate tax and related goals but the premiums are substantially higher than your gifting ability.	• Intra-Family Loans with Life Insurance • Private Split-Dollar	17 17

From Basic to Specialized, The Tools To Build Your Legacy

Basic estate planning tools may be sufficient to meet the estate planning needs of many individuals. But if you have unique family circumstances or more sophisticated assets or planning needs, you and your life insurance producer-may need to explore additional planning

Revocable Living Trust

A revocable living trust is established and funded during your lifetime to hold your assets that do not pass by beneficiary designation or by operation of law. In general terms, a living trust is used to avoid probate and distribute property to the beneficiaries. A living trust is merely a trust that is established during a person's lifetime to hold assets. A living trust is generally revocable until an individual's death. During a grantor's lifetime, property held in a living trust is treated virtually the same as property held in the grantor's name. The grantor continues to use and enjoy the property just as before transferring the property to trust. Establishing a living trust is tax-neutral.

Upon an individual's death, the trust becomes irrevocable, the trustee carries out the trust provisions, and the beneficiaries receive the benefits of the trust. Unlike a will, the assets in the trust are not subject to probate and are not made public. This means that the terms of the living trust (and assets owned by the trust) continue to remain private.*

Life Insurance for the Blended Family or Unmarried Couples[4]

A "blended family" is a family that is formed when a remarriage occurs or when children living in a household share only one (or no) biological parent. The common denominator is children, whether biological, adopted, or with legal caretakers. Blended families can face a real economic crisis should key family members die prematurely. Therefore, the need for life insurance in the blended family is acute, perhaps more so given their complicated nature than with a traditional family. If you have children from a prior relationship, or if your spouse or partner have children from a prior relationship, a life insurance policy on your life may help provide an equitable division of assets.

Life Insurance to Help Pay State Death Taxes

State death taxes may negatively impact your loved ones at your death. Assume, for example, your estate is valued at $5.25 million and you die in a state with a state estate tax and a state exemption amount of $1 million. At your death, you may not owe federal estate tax, but would owe state estate tax on $4.25 million based on your state's estate tax rates. If you had a properly funded and structured life insurance policy, the death benefit proceeds may be utilized to pay the state death taxes.

Probate is a judicial proceeding that enables the court to oversee the distribution of the decedent's property. The rationale behind the probate process is simple; because the decedent is no longer able to represent himself or herself, an unbiased party (i.e., the state) needs to step-in to protect the decedent's interests. The goal of probate is to clear title passing to the decedent's beneficiaries. The documents and assets that are subject to probate are filed with the court and become public.

Family Buy-Sell

A family buy-sell is designed to provide family members who are active in the family business with a source of cash to purchase the business from your estate or from your surviving spouse after you have passed away. Your children who are active in the family business will be the owners and beneficiaries of a life insurance policy insuring your life. Upon your death, the business will be included in your estate and the life insurance death benefit proceeds should be paid income tax-free** to the family members active in the business. They, in turn, use these funds to purchase the family business from your estate under the terms of the family buy-sell agreement. By using this strategy, the business will pass to those family members active in the business and cash will be available to provide for the remaining family members.

Wealth Equalization Using Life Insurance

Often in a family, it can be difficult to equalize wealth among family members. While you want to benefit all your heirs, it is not practical or equitable to distribute all assets equally. For example, if you have a family business in which some of your heirs are active and others are not, you will want the business to go into the hands of those who participate in the business. In such situations, life insurance can be an effective way to equalize the estate for the non-business heirs.

Wealth Stabilization Using Life Insurance

Wealth stabilization involves a combination of planning techniques, diversification strategies, and life insurance to help reduce the impact and volatility a down market has on your wealth transfer plans. If your estate contains a significant portion of assets that are exposed to the volatility of the financial and real estate markets, a down market could wreak havoc on the transfer of wealth to your heirs. Life insurance is a potential asset that may offer less volatility, because the death benefit generally bears no relationship to financial market fluctuations.[5] With the wealth stabilization strategy, you liquidate part or all of an asset you desire to reposition. You then use the proceeds from the liquidated asset to purchase life insurance naming your spouse or heirs as the beneficiary of the policy. Upon your death, your spouse or heirs receive the death benefit proceeds. (Please note that the proceeds can be contributed to an Irrevocable Life Insurance Trust. See page 13 for more details).

Charitable Gifts Using Life Insurance

Many wealthy individuals have a history of giving to their favorite charities. They may want to make sure that these gifts continue should they die prematurely. Life insurance might be a way for these donors to complete their expected lifetime gifts should they die before life expectancy. The three main ways of making a charitable gift with life insurance are: 1) naming the charity as owner and beneficiary of the life insurance policy; 2) naming the donor as owner and the charity as beneficiary; or, 3) the donor transfers an existing policy to charity. Any tax benefits to the donor will vary depending on how the gift to the charity is structured.[6]

**A living trust may also: a) prevent the court from imposing probate fees; b) prevent the expensive and time-consuming process of appointing a conservator to manage your assets; and, c) prevent the expensive and time-consuming process of appointing a guardian or trustee to manage assets for your minor children.*

*** For federal income tax purposes, life insurance death benefits generally pay income tax-free to beneficiaries pursuant to IRC Sec. 101(a)(1). In certain situations, however, life insurance death benefits may be partially or wholly taxable. Situations include, but are not limited to: the transfer of a life insurance policy for valuable consideration unless the transfer qualifies for an exception under IRC Sec. 101(a)(2) (i.e., the "transfer-for-value rule"); arrangements that lack an insurable interest based on state law; and an employer-owned policy unless the policy qualifies for an exception under IRC Sec. 101(j).*

Wealth Replacement Trust Using Life Insurance

If you are charitably-inclined, you may want to leave a part of your estate to your favorite charity. Charitable donations can be made during life or at death and can take many different forms. The downside of any charitable gift is that you are disinheriting the heirs who would have received those assets but for the charitable donation. One solution to this dilemma is to use a wealth replacement strategy with life insurance to replace the lost wealth. With the help of an attorney, you establish an Irrevocable Life Insurance Trust (ILIT) to own and be the beneficiary of a life insurance policy on your life or the lives of you and your spouse. You gift cash to the ILIT in order for the trustee[7] to make premium payments. The gifts may be gift tax-free depending on your ability to use annual exclusions and/or lifetime gift tax exemption. At your death, the life insurance death benefit proceeds will be paid to the ILIT free from estate tax and income tax* and the ILIT trustee will distribute the death benefit proceeds to the trust beneficiaries replacing the assets that you have donated to your favorite charity. By doing so, you will benefit your favorite charity without disinheriting your heirs.

Annual Gifting Program

The federal gift tax is imposed on the gratuitous lifetime transfer of property by an individual to a donee – it is imposed on the person making the gift (the donor) not on the person receiving the gift (the beneficiary). You should not overlook the ability to make a straight forward gift. With the lifetime gift tax exemption at the highest level in the history of the estate tax, taxpayers seeking to transfer wealth may do so by simply giving their assets way to their loved ones.[8] This includes the use of your **annual gift tax exclusion amount.** The annual gift tax exclusion allows you to give another person a gift each year up to $10,000 per recipient, indexed for inflation (there is no limit on the number of recipients to whom you may make annual exclusion gifts). With inflationary adjustments, this amount has increased over time – for example, it was $13,000 in 2012 and $14,000 in 2013. By establishing a lifetime gifting program, one can help control the growth in his or her estate, thus reducing estate taxes at death. Implementing a gifting program with one's annual exclusion gifting may enable wealthier clients to transfer significant wealth simply and with little to no gift tax cost.[9]

Marital and B-Trust Planning with a Will or Living Trust

In some instances, an individual may want to incorporate additional planning into a will or living trust. Depending on one's goals and needs, a will or living trust may be drafted to include an A-Trust (commonly referred to as a "marital trust") and a B-Trust (bypass or credit shelter trust). A **B-trust** is a trust that that is designed to utilize an individual's unused exemption amount so as to shield the assets inside the trust from estate taxes, while as the same time retaining the ability of the assets to be used to provide for the surviving spouse if necessary. A **marital trust** is often utilized in conjunction with a B-Trust but is designed to pass assets to the surviving spouse using the federal unlimited marital deduction (a person's ability to transfer an unlimited amount of wealth to a U.S. citizen spouse). This type of planning may postpone the payment of federal estate taxes until the death of the surviving spouse.

Working with an attorney, a couple's will or living trust is drafted to include provisions that call for the creation of a marital trust and a B-trust at an individual's death. At the first person's death, the trustee utilizes the decedent's assets to fund the B-trust in an amount up to the decedent's unused estate tax exemption amount. The remainder of the decedent's assets are used to fund the marital trust using the unlimited marital deduction. At the surviving spouse's death, the assets in the B-trust pass to the ultimate beneficiaries of that trust.[10] All other assets that are owned by the second-to-die spouse pass via that individual's estate plan. Assets that are not shielded by the surviving spouse's federal estate tax exemption amount may be subject to estate tax.

Portability and the Impact on Marital and B-Trust Planning: With the enhanced federal exemption amount and portability, marital and B-trust planning may not be necessary for a smaller estate because clients can use a simpler "all to spouse" will given that federal estate taxes are no longer an issue. While this may be the case for some individuals, it may not be for others. There continues to be a number of reasons for utilizing marital and B-Trust planning including:

1	*Ensuring the ultimate disposition of the assets meets your intent. If, for example, you and your spouse want to benefit different beneficiaries, marital and B-Trust planning may enable you to do so while still maximizing your exemption amount. This may especially be true in the couple is part of a "blended family" and each have children from prior relationships for whom they want to provide.*
2	*Removing the growth and appreciation outside of your surviving spouse's estate. If you are in a situation where you have an asset that is likely to appreciate greatly, you may want to remove that asset, along with all appreciation, from your surviving spouse's estate. Funding a B-Trust with an asset valued at an amount up to your exemption amount may shield the asset and all future appreciation from the estate tax.*
3	*Addressing the lack of portability on the state level: In states that do have a state estate tax, portability of the state estate tax exemption amount is not available. Marital and B-Trust planning may be necessary for individuals in these states take advantage of both spouses' state estate tax exemptions.*

* *For federal income tax purposes, life insurance death benefits generally pay income tax-free to beneficiaries pursuant to IRC Sec. 101(a)(1). In certain situations, however, life insurance death benefits may be partially or wholly taxable. Situations include, but are not limited to: the transfer of a life insurance policy for valuable consideration unless the transfer qualifies for an exception under IRC Sec. 101(a)(2) (i.e., the "transfer-for-value rule"); arrangements that lack an insurable interest based on state law; and an employer-owned policy unless the policy qualifies for an exception under IRC Sec. 101(j).*

Irrevocable Life Insurance Trusts (ILITs)

If estate taxes and estate inclusion are a concern, an irrevocable trust should be considered. An irrevocable life insurance trust (ILIT) is one type of irrevocable trust that primarily owns life insurance and is used to help prevent life insurance death benefits from being subject to estate taxation. With the assistance of an attorney, you establish an ILIT to be the owner and beneficiary of a life insurance policy insuring your life or the lives of you and your spouse. You transfer cash to the ILIT in order for the trustee of the ILIT to pay life insurance premiums. Whether or not these transfers are subject to gift tax depends on your ability to make annual exclusion gifts and/or to use your lifetime gift tax exemption. After your death, the life insurance death benefit proceeds can be used by the trustee of the ILIT to purchase assets from or lend money to your estate in order to provide your estate with the liquidity necessary to pay any estate tax due.

It is important to remember that an ILIT is irrevocable and you will not be able to change its terms after the ILIT has been established. Also, the assets that you transfer to the ILIT are no longer your assets. The person or bank you have chosen as trustee will manage the ILIT's assets, and the individuals who have been named as beneficiaries will receive those assets pursuant to the terms of the ILIT.

Spousal Lifetime Access Trust (SLAT)

A spousal lifetime access trust (SLAT) is a special type of irrevocable trust that may help a married couple keep the life insurance death benefit proceeds outside of their estate and still provide indirect access to the cash value. You, with the help of an attorney, establish the SLAT. The SLAT, like all ILITs, is irrevocable. You then gift separate property funds to the SLAT, which names your spouse as the lifetime beneficiary. Whether the gifts to the SLAT are subject to gift tax depends on your ability to make annual exclusion gifts and/or use your lifetime gift tax exemption amount. The SLAT trustee then purchases a life insurance policy on your life using these gifts. The SLAT is the owner and beneficiary of the policy.

During your lifetime, the terms of the SLAT will give the trustee of the SLAT the discretion to take loans and withdrawals, which may be income tax-free[11] if within limits and up to basis, from the life insurance policy's available cash value. If the SLAT has no other taxable income, the trustee, within his or her discretion, may then make income tax-free[12] and gift tax-free distributions to your spouse. In this manner, a SLAT may enable the parties to have indirect access to the trust assets. At your death, the SLAT trustee may then make distributions to the SLAT beneficiaries in accordance to the terms of the SLAT.

Dynasty Trust Planning: Enhanced Generation Skipping Transfer Trust Planning

Leaving a legacy for your children, grandchildren, and future generations may be one of the most important goals for larger estates. With a federal transfer tax system designed to tax property each time it passes from one generation to the next, efficient generational wealth transfer requires planning. A dynasty trust is an irrevocable trust used by those clients who want to leave a legacy for children, grandchildren, and future generations. Unlike other types of irrevocable trusts, a dynasty trust is designed to continue for as many generations as permissible under state law and to protect the assets in the dynasty trust from not only gift and estate taxes but also from the GST tax.[12]

With the assistance of an attorney, you establish a dynasty trust to be the owner and beneficiary of a life insurance policy insuring your life or the lives of you and your spouse. You transfer cash to the dynasty trust in order for the trustee of the dynasty trust to pay life insurance premiums. Whether or not these transfers are subject to gift tax depends on your ability to make annual exclusion gifts and/or to use your lifetime gift tax exemption. Assuming that your GST exemption is fully allocated to all gifts to the trust, assets owned by the dynasty trust, including the life insurance death benefit proceeds, will not be subject to estate tax or GST tax.

Grantor Retained Annuity Trust (GRAT)

A grantor retained annuity trust (GRAT) is an irrevocable trust that allows you to retain an income stream for a defined time period with the remainder passing to your designated trust beneficiaries. While there may be an initial gift when the property is contributed to the GRAT, the taxable gift is equal to the fair market value of the property reduced by your retained annuity interest. Based on the term and the retained annuity stream of the GRAT, there may be little or no gift tax imposed at the time the GRAT is established.[13] If you survive the GRAT term, at the expiration of GRAT, ownership of the remaining property passes to the remainder beneficiaries of the GRAT without the imposition of additional gift tax. If you fail to survive the selected term of the GRAT, a portion of the trust will be included in your estate for estate tax purposes.

Life insurance should not be purchased in the GRAT because there is the possibility that you may die during the GRAT term which would cause a part of the GRAT assets, including the life insurance death benefit proceeds, to be included in your taxable estate. The grantor or the GRAT beneficiaries often utilize life insurance owned outside the GRAT to insure against the risk of the grantor's death during the selected term.

Qualified Personal Residence Trust (QPRT)

A qualified personal residence trust (QPRT) is an irrevocable trust to which an individual transfers his or her primary residence or a secondary residence, reserving the right to live in the residence rent-free for a term of years, the remainder interest passing to specified beneficiaries. While there may be an initial gift tax imposed upon the transfer of the remainder interest in the QPRT, ownership of the residence eventually passes to an individual's beneficiaries without the imposition of additional gift tax if an individual survives the selected term. While a successful QPRT should reduce the grantor's overall estate tax liability, it may create a liquidity problem because the grantor's residence cannot be sold to pay any estate tax due on the balance of his or her gross estate. Life insurance may be an excellent source of estate tax liquidity to prevent the forced sale of other assets to pay the potential estate tax due upon the grantor's death.

If the grantor fails to survive the selected term, all or a portion of the value of the residence will be included in his or her gross estate. For this reason, the grantor or the QPRT beneficiaries often utilize life insurance to insure against the risk of the grantor's death during the selected term.

Installment Sale to an Intentionally Defective Irrevocable Trust (IDIT Sale)

An installment sale to an intentionally defective irrevocable trust (IDIT Sale) is a deferred sale arrangement between you and an irrevocable trust. This irrevocable trust is "intentionally defective" for income tax purposes -- meaning that transfers to the trust are incomplete for income tax purposes even though they are complete for gift and estate tax purposes. This means that you, as grantor, are treated as the income tax payer and are responsible for all income taxes generated in the trust.

With the help of your attorney, you establish an IDIT and gift cash or some assets to the IDIT to "seed" the trust. This "seed" gift may be subject to gift taxes. Next, you sell property to the IDIT in exchange for an interest-bearing installment note payable over a term of years you select. The trustee of the IDIT uses the income from the assets held by the IDIT to make the installment note principal and interest payments. Because the IDIT is "intentionally defective," all income generated by the assets held in the IDIT is reported on your income tax return. In addition, no gain is triggered at the time the property is sold to the IDIT and interest payments from the ILIT are not taxable to the grantor. To provide estate tax liquidity, the trustee may utilize a portion of the IDIT's assets or income to purchase and own life insurance on your life. At your death, the life insurance death benefit proceeds pass to your heirs per the terms of the trust.

Family Limited Partnership (FLP)

A family limited partnership (FLP) is a legal entity established under an individual's state partnership laws. FLPs are used to consolidate and manage wealth, provide some asset protection and, in the estate planning context, to transfer property to junior generations at a reduced transfer tax cost. Working with your legal and tax advisors, you transfer appropriate assets to an FLP. The FLP is designed to have general partnership interests and limited partnership interests. You then utilize some of your gifting to transfer the limited partnership interests to your loved ones. Depending on the restrictions placed on the limited partnership interests, an appraiser may discount the value of the limited partnership interests to reflect the lack of marketability of the limited partnership interest and the limited partner's lack of control over the FLP.

FLPs have been historically disfavored by the IRS and may be subject to greater IRS scrutiny. Please consult with legal and tax counsel prior to implementing this, or any other strategy, discussed in this brochure.

Even though gifting or selling discounted interests in an FLP may reduce the size of an individual's estate, most ultra wealthy individuals will still have a taxable estate at death. This is likely the case because they are unwilling to give away everything that they own prior to death. Life insurance, likely owned in an irrevocable life insurance trust (ILIT) may provide the liquidity the estate needs to pay the resulting estate tax.

Charitable Remainder Trust (CRT) with a Wealth Replacement Trust

For individuals seeking to fulfill philanthropic goals while also retaining an income stream, a charitable remainder trust (CRT) may be an ideal strategy. This may include, but is not limited to, a desire to help a certain charity or charities fulfill their purpose, a desire to benefit private foundations, and the need to defer capital gains tax on appreciated assets.

With the help of an attorney, you establish a CRT and transfer assets to the CRT. You irrevocably transfer a highly appreciated asset to the CRT. In return, you will receive a charitable income tax deduction based on the calculated value of the gift to charity. The CRT, in its discretion, sells the asset and reinvests the proceeds in income-producing assets. Depending on the structure, you will receive income from the CRT (which may or may not be taxable) for your life, the lives of you and your spouse, or a specified term not to exceed 20 years. Upon your death(s), any assets remaining in the CRT pass to the designated charity.

Given that your heirs will not receive the asset that passes to the charity at your death, a CRT may be used in conjunction with a wealth replacement trust –discussed earlier on page 11.

Intra-Family Loans with Life Insurance

Life insurance premiums paid with an intra-family loan may help wealthy individuals minimize gift taxes. The purchase of life insurance using intra-family loans involves the insured or his/her spouse lending money to the ILIT either annually or in a lump sum. The intra-family loan, if structured properly, should not be considered a gift for gift tax purposes because it is a loan – not a gift. The insured or his/her spouse, with the help of his or her attorney, lends money to the ILIT (via a private IRC Section 7872 loan) to assist in premium payments for a life insurance policy on the life of the insured (or his/her spouse).[14] The loan bears an interest rate equal to the applicable federal rate (AFR) in effect on the day the loan is made.

The trustee[7] of the ILIT purchases a life insurance policy on the insured's life (or the life of his/her spouse), retains ownership rights, and designates the ILIT as beneficiary of the policy. Pursuant to the loan agreement, the ILIT trustee collaterally assigns a portion of the death benefit and cash surrender value to the insured as lender using a restricted collateral assignment. At the expiration of the predetermined loan term, the loan balance can be repaid to the lender using any available cash surrender value from the life insurance policy and/or any other asset owned by the ILIT. If the insured (or insureds) pass away before the loan balance has been completely repaid, the ILIT can repay the loan from the life insurance death benefit proceeds. The remaining death benefit should be paid to the ILIT and should pass to the heirs free from income tax* and estate tax.

Private Split-Dollar

Life insurance premiums paid by an irrevocable life insurance trust (ILIT) with a private split-dollar strategy may help wealthy individuals minimize gift taxes. Private split-dollar is a premiums sharing arrangement typically between an Irrevocable ILIT and an insured. With the help of an attorney, you establish an ILIT to be the owner and the beneficiary of a policy on your life or the lives of you and your spouse. At the same time, you or your spouse enter into a private split-dollar arrangement with the ILIT where you or your spouse agree to pay the life insurance premium in exchange for a restricted collateral assignment over the cash value of the policy. The ILIT agrees to pay the cost of the current life insurance protection as measured by the reportable economic benefit (REB).[15] You and/or your spouse will gift at least enough cash to the ILIT so that the trustee can pay the REB. At the death of the insured(s), an amount equal to the cash value is paid to the collateral assignee. The remainder of the death benefit proceeds should be paid to the ILIT free from income tax* and estate tax.

* *For federal income tax purposes, life insurance death benefits generally pay income tax-free to beneficiaries pursuant to IRC Sec. 101(a)(1). In certain situations, however, life insurance death benefits may be partially or wholly taxable. Situations include, but are not limited to: the transfer of a life insurance policy for valuable consideration unless the transfer qualifies for an exception under IRC Sec. 101(a)(2) (i.e., the "transfer-for-value rule"); arrangements that lack an insurable interest based on state law; and an employer-owned policy unless the policy qualifies for an exception under IRC Sec. 101(j).*

Endnotes

1 *There are many different types of wills. A detailed discussion is beyond the scope of this piece. Please consult with legal counsel for more information.*

2 *Each state has its own set of requirements for a DPOA to be valid so local counsel should be consulted.*

3 *"The End of a Decade of Uncertainty Over Gift and Estate Taxes", New York Times, P. Sullivan, January 4, 2013 (found at: http://www.nytimes.com/2013/01/05/your-money/fiscal-deal-ends-decade-of-uncertainty-over-gift-and-estate-taxes.html?pagewanted=all&_r=0). The article states: "You could say this eliminates the estate tax for 99 percent of the population, though I've seen figures that say 99.7 or 99.8," said Richard A. Behrendt, director of estate planning at the financial services firm Baird and a former inspector for the Internal Revenue Service.""*

4 *Please note a prerequisite for this strategy is establishing insurable interest. Insurable interest laws vary by state. Not all states have statutes that specify that unmarried couples have an insurable interest in each other. You may need to demonstrate insurable interest if you reside in a state that does not statutorily provide it to unmarried couples. Insurable interest may be established by providing evidence of the relationship relevant to insurable interest laws. This evidence may include, but is not limited to, jointly owned assets and business interests, wills and trusts. Assuming insurable interest is established, financial justification for the amount of life insurance coverage applied for will depend on the extent of financial loss to one party at the death of the other.*

5 *Death benefits have no correlation with fluctuations in the financial markets assumes that the policy remains in force, the death benefit is Option A, and the death benefit is not the Minimum Death Benefit as that term is used in the policy. Cash value, especially with variable life insurance policies, can correlate with fluctuations in the financial markets due to either the impact of market fluctuations on the performance of your investment options, or in the reduction of your policy's current crediting rate. To the extent cash value is less than illustrated, additional premiums may be required to keep the policy in-force until death. Cash value also has a direct impact on the death benefit with all death benefit options other than level. Finally, to the extent cash value is less than illustrated- due to the impact of market fluctuations, failure to pay premiums as illustrated, increased policy charges, or otherwise - your policy's net amount at risk will be increased, which increase will cost of insurance charges.*

6 *To prevent people from speculating on the lives of random acquaintances, only someone with an insurable interest in the life of the insured may purchase a life insurance policy on that person. In order for a life insurance policy to be considered valid, it must meet the insurable interest rules in the state in which it is issued. Most states have enacted laws giving a charitable organization an insurable interest in a donor. However, before creating a charitable plan using life insurance, state law should be consulted. The IRS has taken the position that if charity does not have an insurable interest under state law, then no income, gift, or estate tax deduction would be allowed.*

7 *The trustee appointed should not be the insured or the insured's life insurance producer. A life insurance producer who is paid a commission on the sale of a life insurance policy represents both his or her personal interest and the interests of the trust, creating a conflict of interest.*

8 *A gift tax return must be filed with IRS if a taxpayer utilizes any of his or her lifetime gift tax exemption amount.*

9 *It's important to keep in mind that a lifetime gifting program should be tailored to meet a person's needs. To this end, a gifting program may not be prudent for individuals with smaller estates as it may jeopardize their livelihood or lifestyle.*

10 *Transferring assets to a B-Trust may enable individuals to remove the asset as well as any appreciation or growth the asset may experience.*

11 *Tax-free income assumes, among other things: (1) withdrawals do not exceed tax basis (generally, premiums paid less prior withdrawals); (2) policy remains in force until death; (3) withdrawals taken during the first 15 policy years do not occur at the time of, or during the two years prior to, any reduction in benefits; and (4) the policy does not become a modified endowment contract. See IRC §§ 72, 7702(f)(7)(B), 7702A. Any policy withdrawals, loans and loan interest will reduce policy values and may reduce benefits.*

12 *The duration of the dynasty trust may be indefinite or limited to a number of years, depending on the applicable state's rule against perpetuities which limits the duration of a trust. If the trust is established in a state with no rule against perpetuities, the trust continues indefinitely for the benefit of future generations until the trust assets are depleted.*

13 *The gift to the GRAT may be valued at zero or at an amount close to zero for gift tax purposes if the GRAT is structured as a "zeroed-out GRAT." With a zeroed-out GRAT, the retained annuity interest is structured high enough so that the gift tax value of the gift is close to zero.*

14 *IRC Sec. 7872 loans are debt arrangements that are structured within the guidelines set forth in Treas. Reg. Sec. 1.7872-15. Treas. Reg. Sec. 1.7872-15 contains guidelines as to what will constitute sufficient interest on a loan for the purchase of life insurance as to avoid below-market treatment under the rules of IRC Sec. 7872.*

15 *Final Split-Dollar Regulations (Treas. Reg. 1.61-22(d)3(ii)) reserve the issue of the cost of current life insurance protection for future guidance. Until such guidance is issued, Notice 2002-8 states that taxpayers may continue to use the insurance carrier's published one year term rates or the Table 2001 rates for arrangements entered into prior to January 28, 2002. For arrangements entered into after that date, taxpayers are generally limited to the Table 2001 rates.*

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Pacific Life Insurance Company
Newport Beach, CA
(800) 800-7681 • www.PacificLife.com

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