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4 estate planning tips for clients

By Nancy Burner, Henry Montag November 16, 2021

Amid the COVID-19 pandemic, staying informed about life insurance strategies with trusts and estates is critical. Timely and effective access to information, and planning utilizing this knowledge, can be key ways to preserve a client's hard-earned assets while anticipating future needs that may arise. Here are some ideas to consider:

1 SLATS and alternate funding options

The use of a spousal limited access trust is a key estate planning strategy for some clients. Using a SLAT preserves the federal exemption before it is reduced. A SLAT is an irrevocable trust created by one spouse for the benefit of the other during their lifetime. The purpose of a SLAT is to freeze the values of the transferred assets at their current value and to exclude any appreciation from the estate of either spouse.

Married clients looking to engage in proactive estate tax planning should be reviewing the viability of this type of plan for their situation. It can be especially useful in long-term marriages where clients are looking to balance flexibility with maximum wealth transfer for future generations.

Suppose the couple has a taxable estate in excess of $15 million and fears the federal exemption will be reduced to $6.0 million (indexed for inflation in 2026). In order to utilize the full $11.7 million, one spouse could put $11.7 million in a SLAT for the other spouse, thereby utilizing the full federal exemption before it is reduced. The beneficiary spouse would have access to the trust and yet it would not be taxable in that spouse's estate. The beneficiary spouse might even have a limited power of appointment, allowing the grantor spouse to be a beneficiary if the grantor spouse is the survivor.

With the prospect of the $11.7 million per person federal exemption being reduced substantially at some point in the future, a SLAT allows the client to utilize the full exemption. The next question becomes where to place the assets used to fund the SLAT.

Recognizing that most gifting strategies require the taxpayer to give away assets with no strings attached, many couples with significant assets are still reluctant to give away assets for fear they someday may need the gifted assets. An ideal solution would be the purchase of a traditional cash value life insurance policy, or if the annual premium is over $500,000, a private placement life insurance policy would be more appropriate, (further explained below). Both policies represent completed gifts, which means that trust assets are removed from the couple's gross estate, along with a tax-free leveraged death benefit, and a growing tax deferred accumulation fund. This gives a beneficiary's spouse the ability to make a completed gift, yet access the policy's cash value on a tax-favored basis if the assets are ever needed in the future.

For planning purposes, a couple can use a single-life or a second-to-die policy. In either case the policy should be owned by a SLAT if it's single life, or an irrevocable life insurance trust if it's a second-to-die policy. This will avoid any incidence of ownership by the grantor or grantors and allow the ILIT or the SLAT to receive the policy's death benefit free of income and estate taxes, while providing creditor protection and management by the trustee.

2 Filing portability for a deceased spouse

Clients who lost a spouse after 2012 but did not file a timely estate tax return on Form 706 should be seeking advice to determine if they should take advantage of the deceased spouse's unused federal exemption.

For example, assume a surviving spouse has a $10 million taxable estate. Perhaps the surviving spouse should file an estate tax return for the deceased spouse and then use the deceased spouse's unused exemption, thus eliminating a tax on the estate of the second to die. The portability election must be made on a timely filed estate tax return. However, even if the estate tax return was not filed, there may be some exceptions that will allow a late filing of the return to elect portability. Clients can check with their estate attorney.

The best way to fund these future estate tax liabilities is with a guaranteed universal second-to-die life insurance policy to the youngest spouses. Doing so will result in the least expensive annual premium outlay, as there is no need to build up any cash value since we're only looking for the maximum death benefit protection. While a second-to-die policy makes sense most of the time, it's always important to compare the cost to only insure the younger and/or healthier person to determine if there's enough of a premium difference to justify the risk of only insuring one person.

3 SECURE Act workarounds to offset future taxes

Lifetime stretch IRAs are gone due to the SECURE Act of 2019, with limited exceptions. Prior to the enactment of the SECURE Act, beneficiaries were able to stretch IRA distributions over a spouse's lifetime in their retirement accounts. When that was the case, many clients were advised to have their retirement benefits made payable to conduit trusts. This would allow the RMD to be paid to the beneficiary while the remainder of the assets would enjoy the creditor protection and other protections that the trust afforded.

In light of the SECURE Act and the required 10-year payout for most clients, many of them are concerned that a shorter payout will leave these assets unprotected in the hands of the beneficiaries. To avoid this result, retirement benefits can be made payable to accumulation trusts, rather than a forced payout to the beneficiary under the conduit trust.

Clients who have named trusts created by their last will and testament or a living trust for the benefit of their beneficiaries should have these documents reviewed. It is important for them to understand the impact of the SECURE Act and consider changes to the beneficiary trusts.

Similarly, as a result of the SECURE Act's shortened payout period, life insurance and annuities will become a more visible and important planning tool as people realize life insurance is an efficient way for children and non-spouse beneficiaries to pay the future increased income taxes on their distributions to prevent the further erosion of their inheritance. All annuities associated with an IRA will have to be reviewed to make certain there are no payouts to beneficiaries lasting longer than 10 years.

These additional taxes as a result of inheriting their parents' IRAs will come at a time when they'll most likely be in their highest earning years. To make matters worse, they'll now have to declare more income as they must bunch up these IRA distributions over a 10-year period

One way to offset the higher future income tax liability would be for the owner of the IRA to gift their IRA assets or RMD distributions to purchase sufficient second-to-die life insurance coverage, which can be arranged to be available when needed to pay the additional taxes in the tenth year.

4 Private placement life insurance

Traditional life insurance will accomplish the objective of providing a traditional leveraged tax-free death benefit as well as a tax-favored accumulation and distribution vehicle that serves the needs of 95% of clients. However, a more efficient type of life insurance for the ultra-high-net-worth individual is private placement life insurance. This type of life insurance differs from retail life insurance in several distinct ways. The institutional commissions are significantly lower than the traditional retail commissions. The health ratings of the class of people insured offer better mortality rates, which the insurer passes on to the individuals insured.

There are no penalties nor surrender charges for early withdrawals. There's also the benefit of using hedge funds as an investment vehicle rather than the traditional retail sub accounts. In addition, there are significant tax and investment advantages to using hedge funds in a tax-deferred life insurance policy where an investment manager doesn't have to pay capital gains taxes nor ordinary income taxes every time a successful trade is completed.

If you have a client who is paying upwards of $500,000 in annual premium and isn't taking advantage of a PPLI policy, you should advise them of their options. Lastly, the government via Section 7702 has made it more advantageous for a larger percentage of premium dollars to now be allowed to accumulate tax-deferred in a life insurance policy.

Private placement life insurance usually works best for individuals seeking to customize their policy to obtain various specific benefits to fit their particular needs, i.e., placing nontraditional assets into the PPLI. However, doing so requires legal and accounting services and, since it's a security, also requires governmental setup fees. For those seeking the more traditional benefits, including doing away with retail commissions, more efficient tax treatment on their investment transactions, that result in lower costs and larger cash accumulations, they can obtain coverage from several insurers offering no-commission or low-commission products for high-net-worth clients.

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He has appeared as a guest on Wall Street Week, Fox Business News & News 12. He's provided CPE & CLE continuing education credits to NYSBA, ABA, AICPA, NYSSCPA, & the estate Planning Council. He co-authored an American Bar Association Flagship publication, Jan 2017, titled; "The Advisors' & Trustees' Guide to Managing Risk" The Jan 2019 issue of Commerce Clearing House, referred to him as; "One of today's best brains in life Insurance.