CRESCENT PRIVATE CLIENT GROUP

ESTATE PLANNING PLAYBOOK

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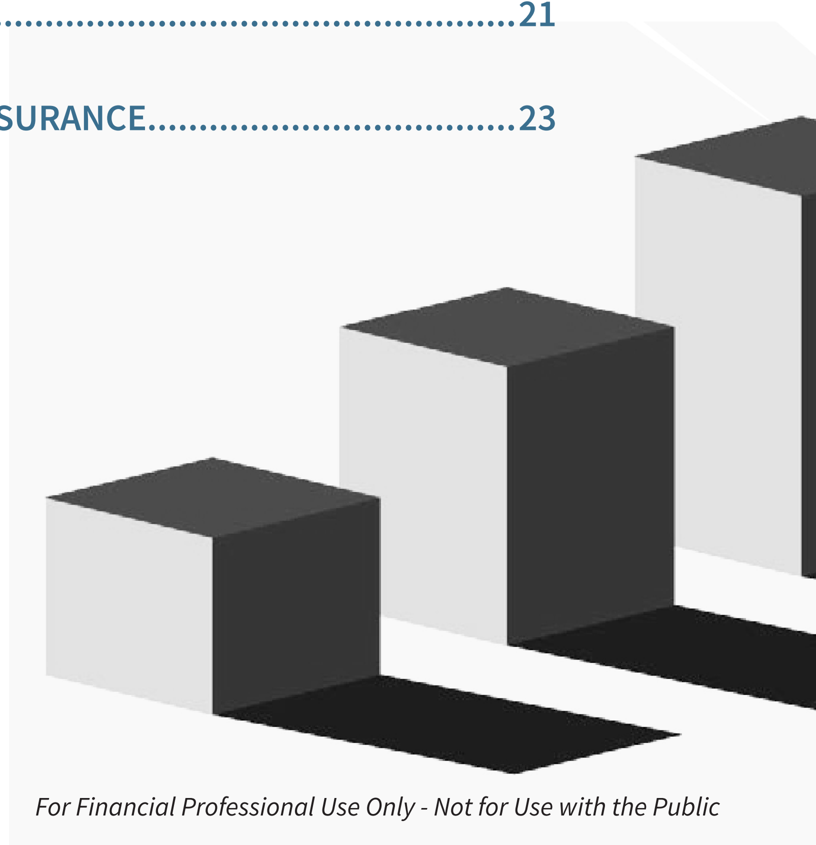

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FEDERAL TRANSFER TAX SYSTEM

Estate Tax

CONCEPT DESCRIPTION

The federal transfer tax system comprises three taxes: the estate tax, the gift tax, and the generation-skipping transfer tax (GSTT). Unlike the income tax system, where a tax is imposed on the value of an asset, a tax is placed on the transfer of wealth from one individual to another in the transfer tax system. An asset may be subject to both federal income taxes and a transfer tax, depending on the type of transaction. Under tax law, the Federal Government exempts a specific dollar amount from transfer taxes — known as the applicable exclusion amount for gift, estate, and the GSTT ($13.61 million in 2024, indexed).

The estate tax is often described as a voluntary tax. There are numerous ways to minimize transfer taxes if the system is understood and the advice of competent professionals is sought before substantial gifts are made as part of the estate planning process.

CLIENT PROFILE

High net-worth (HNW) individuals who desire to pass their assets to heirs and want to avoid the tax loss that happens when they die. HNW Families seeking tax-advantaged solutions and are concerned about an increase in estate taxes if the applicable exclusion is cut in half on January 1, 2026.

HOW ESTATE TAX WORKS

The federal estate tax applies to assets transferred at death (Reporting occurs on IRS Form 706).

» Determining what property is calculated in the gross estate includes worldwide assets owned at death.

- Ownership for this purpose is vast and will even include property transferred before death, such as life insurance policies transferred within the last three years.
- The marital deduction and charitable deduction eliminate any estate tax on these transfers.
- Also, no estate tax is applied to any administrative expenses, funeral expenses, debt, or cost for administering the estate.

» After deductions, the remainder of the estate is subject to estate tax.

» Once the estate tax is calculated, any portion of the client's remaining exclusion amount not used to shelter lifetime gifts from gift tax can be used against the estate tax. So, if the client hasn't made any taxable gifts during their lifetime, the total applicable exclusion amount remains available.

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Key Selling Points

- Many states impose their own transfer taxes. These taxes are generally imposed at lower rates than the federal transfer tax rates. Any amounts paid to the state for transfer taxes are allowed as deductions in determining the federal tax.
- Transfer-of-life insurance policies to remove the excess of the death benefit over the value at the date of gift from the estate is common and very tax efficient. Transfers of annuities are typically considerably less tax-efficient.
- The basis for determining gain varies depending on whether the property is received by gift or inheritance.
- Although gifts and transfers at death are part of a unified system, one may produce better results than the other, depending on the situation.

CASE STUDY

A widower dies in 2024, leaving $20M to his children. He hasn't made any taxable gifts. Under the law in place at the time of his death, he had a $13.61M applicable exclusion amount available and a 40% top tax rate.

In this example, no federal estate tax is due on the first $13.61M passing to his children; estate tax will be due on the remaining $6.39M at the 40% tax rate. Fortunately, he'd purchased a $3M life insurance policy ten years ago as part of his estate planning. This provides the necessary funds for his children to pay the federal and state estate tax owed, plus the income taxes payable on his IRA assets transferred at death.

CLIENT COMMENTS TO LOOK OUT FOR

"Our parents just passed and we inherited substantial assets. What should we do with them?"

"I'm concerned about the taxes potentially incurred when the exemption is cut in half."

"What'll happen to my business if I pass unexpectedly?"

"What assets would be best used to fund our estate plan and/or ILIT?"

RIGHT QUESTIONS TO ASK

"Have you done estate planning, and when was it last reviewed?"

"Are you aware the estate tax will become more prevalent on January 1, 2026?"

"Have you considered the conflict created when only one of your children inherits your family business?"

FEDERAL TRANSFER TAX SYSTEM

Gift Tax

CONCEPT DESCRIPTION

The federal transfer tax system comprises three taxes: the estate tax, the gift tax, and the generation-skipping transfer tax (GSTT). Unlike the income tax system, where a tax is imposed on the value of an asset, a tax is placed on the transfer of wealth from one individual to another in the transfer tax system. An asset may be subject to both federal income taxes and a transfer tax, depending on the type of transaction. Under tax law, the Federal Government exempts a specific dollar amount from transfer taxes — known as the applicable exclusion amount for gift, estate, and the GSTT ($13.61 million in 2024, indexed).

The gift tax is often described as a voluntary tax. There are numerous ways to minimize transfer taxes if the system is understood and the advice of competent professionals is sought before substantial gifts are made as part of the estate planning process.

CLIENT PROFILE

High net-worth (HNW) individuals who desire to pass their assets to heirs and want to avoid the tax loss that happens when they die. HNW Families seeking tax-advantaged solutions and are concerned about an increase in estate taxes if the applicable exclusion is cut in half on January 1, 2026.

HOW GIFT TAX WORKS

The gift tax applies to assets transferred during life (Reporting occurs on IRS Form 709).

- Current law provides that an annual gift can be made to an individual where no gift tax is due (the annual exclusion is $18,000 in 2024, indexed). All gifts to that individual above the annual exclusion are subject to gift taxation reporting.
- Payment of someone's tuition or medical expenses is typically not considered a taxable gift.
- After a gift is made, appreciation isn't included in the donor's estate when determining the estate tax.
- The gift tax doesn't apply to certain transfers to a US Citizen spouse or to transfers to qualifying charities.
- Where a gift is made to someone other than a spouse or charity and a portion of the gift exceeds or doesn't qualify for the annual exclusion or the exclusion for educational or medical expense, such portion is a "taxable gift" subject to the gift tax.

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Key Selling Points

- Many states impose their own transfer taxes. These taxes are generally imposed at lower rates than the federal transfer tax rates. Any amounts paid to the state for transfer taxes are allowed as deductions in determining the federal tax.
- Transfer-of-life insurance policies to remove the excess of the death benefit over the value at the date of gift from the estate is common and very tax efficient. Transfers of annuities are typically considerably less tax-efficient.
- The basis for determining gain varies depending on whether the property is received by gift or inheritance.
- Although gifts and transfers at death are part of a unified system, one may produce better results than the other, depending on the situation.

CASE STUDY

A woman transfers an existing life insurance policy to an irrevocable trust (ILIT) in 2024 by changing ownership to the ILIT. Her basis (the amount paid) in the life policy is $100,000; the fair market value of the life policy is $150,000 (as reported by the life insurance carrier); there's one beneficiary of the ILIT; the annual exclusion is $18,000; and the applicable exemption amount is $13.61M.

A taxable gift of $132,000 to the ILIT ($150,000 policy value less $18,000 annual exclusion) must be reported on IRS Form 709. Assuming she's made no other taxable gifts, she has $13.478M of exclusion amount remaining ($13.61M - $132,000). There are no income tax consequences. However, she must survive three years from the date of transfer, or the policy's death benefit will be included in the estate tax calculation (IRC §§ 2035, 2042).

CLIENT COMMENTS TO LOOK OUT FOR

"Our parents just passed, and we inherited substantial assets. What should we do with them?"

"I'm concerned about the taxes potentially incurred due to the exemption being cut in half"

"What'll happen to my business if I were to unexpectedly pass?"

"What do you mean my traditional IRA is subject to estate and income taxation?"

RIGHT QUESTIONS TO ASK

"Have you done estate planning and when was it last reviewed?"

"Are you aware the estate tax will become much more prevalent on January 1, 2026, and by gifting assets now, you can substantially reduce taxation caused by their ownership?"

"Have you considered the conflict when not all your children inherit your family business?"

IRREVOCABLE LIFE INSURANCE TRUST

Managing money after death

CONCEPT DESCRIPTION

An irrevocable life insurance trust (ILIT) is created by the grantor/insured and used to remove the death benefit from the insured's estate for estate tax purposes. The grantor gives up all rights to the property transferred to the trust and retains no rights to revoke, terminate, or modify the trust in any material way.

Why use ILITs in estate planning?

- Helps meet the liquidity needs of the grantor's estate
- It avoids estate taxation of the death proceeds
- Helps provide for the income needs of survivors after liquidity requirements have been satisfied
- Shelters property from creditors at death

CLIENT PROFILE

Someone with estate tax issues who purchases life insurance to meet the estate's liquidity need. Someone who wants to provide instructions after death regarding who should receive distributions, when, and how much.

HOW AN ILIT WORKS

» The grantor transfers a life insurance policy to the trust, or the trustee applies for a new policy.

- The beneficiaries of the trust are often family members.
- If the policy transfer occurs less than three years before the grantor's death, the death benefit is subject to estate tax.

» The grantor transfers cash annually to the trust, which can be sheltered from the gift tax by the gift tax annual exclusion. Any gift not qualifying for the annual exclusion reduces the lifetime exemption available or is subject to gift tax.

» The trustee makes premium payments.

» At the grantor's death, the trust receives the death benefit from the policy.

» The trust gives the trustee the power to make loans to the grantor's estate or to purchase assets from the estate to provide the estate with funds to help pay estate settlement costs. The trustee doesn't make the payments directly.

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Key Selling Points

- The gift tax associated with transferring a policy is (1) the total premiums paid on a newly issued policy; (2) the cost of a comparable policy with the insured's attained age on a paid-up or single premium policy; or (3) the "interpolated terminal reserve" plus unearned premium on a previously issued policy still in premium paying status.
- Transferring cash to an irrevocable trust is considered a "future interest" gift. Therefore, the annual exclusion is unavailable because the trust's beneficiaries can't access and use the gift. However, giving some or all of the trust's beneficiaries a temporary right to withdraw some or the entire gift make it a "present interest" gift.
- To make the transfer a present interest gift, the trustee notifies the beneficiaries of the temporary right to withdraw funds from the trust (a "Crummey Notice"). If the beneficiary doesn't exercise this right within the stated period of withdrawal (usually 30 – 45 days), then the right "lapses" and the gift is considered a "present interest" gift. Once the withdrawal right lapses, the trustee can use the gifted funds to pay premiums.
- At the insured's death, the trust should receive death benefit proceeds income-tax-free and estate-tax-free. These proceeds can be used to provide liquidity to pay estate taxes by making loans to the decedent's estate or purchasing assets from the estate.
- If the insured has an "incident of ownership" in the life insurance policy at death (or within three years prior to death), the death-benefit value is brought into the insured's gross estate. The trust beneficiaries will receive the actual proceeds, but the proceed amounts will be included in the insured's gross estate value.
- Paying premiums isn't an incident of ownership. However, gift taxes are associated with paying premiums on a life insurance policy not owned by the premium payor.
- To avoid the three-year look-back rule, the client can gift money to the trust so the trustee can buy the policy from the grantor for its fair market value. Purchasing the policy avoids the look-back rule. Take care to ensure that the sale is for the policy's fair market value.

CLIENT COMMENTS TO LOOK OUT FOR

"My advisor tells me I have an estate tax issue and need to purchase a life insurance policy."

"Is owning a life insurance policy the best way to get funds to my family?"

RIGHT QUESTIONS TO ASK

"Would you like to control how, when, and why your children receive funds from your life insurance?"

"Would you like to protect your life insurance proceeds from the creditors, predators, and future ex-spouses of your beneficiaries?

DYNASTY TRUST

Minimizing estate taxes across generations

CONCEPT DESCRIPTION

A dynasty trust is a powerful tool that's available to help provide for current and future generations. It's designed to maximize the use of the donor's generation-skipping transfer tax (GSTT) exemption. This is typically done during life by allocating the GSTT exemption when creating the trust. When a dynasty trust is properly structured, the assets left in the trust aren't subject to estate taxes when they pass from generation to generation.

A dynasty trust is a way for clients to provide financial security for their children and future generations. A dynasty trust can be funded with many types of assets, although life insurance is often used to maximize the amount of wealth transferred to the trust beneficiaries.

CLIENT PROFILE

Someone who wants to create a legacy for the generations to come. Someone wanting to provide guidance beyond their death regarding who should receive distributions, when, and how much for future generations.

HOW A DYNASTY TRUST WORKS

- The client establishes a dynasty trust that's the owner and beneficiary of a life insurance policy.
- The client transfers cash or assets to the dynasty trust.
    - Whether or not these gifts are subject to gift tax depends on your client's annual exclusions and/or lifetime gift-tax-exemption amounts. In addition, the client will need to allocate some or all of their GSTT exemption to the contributions made to their dynasty trust to avoid the tax.
- All future growth or death benefits won't be subject to future estate tax.
- All future distributions of interest and principal are distributed free of the GSTT for the trust's duration.

Key Selling Points

- The gift tax associated with transferring a policy is (1) the total premiums paid on a newly issued policy; (2) the cost of a comparable policy with the insured's attained age on a paid up or single premium policy; or (3) the "interpolated terminal reserve" plus unearned premium on a previously issued policy still in premium paying status.
- Transferring cash to an irrevocable trust is considered a "future interest" gift. Therefore, the annual exclusion isn't available because the trust's beneficiaries can't currently access and use the gift. However, the gift can be made a "present interest" gift by giving some or all of the trust's beneficiaries a temporary right to withdraw some or the entire gift.
- To make the transfer a present interest gift, the trustee notifies the beneficiaries of the temporary right to withdraw funds from the trust (a "Crummey Notice"). If the beneficiary doesn't exercise this right within the stated period of withdrawal (usually 30 – 45 days), then the right "lapses" and the gift is considered a "present interest" gift. Once the withdrawal right lapses, the trustee can use the gifted funds to pay premiums.

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- At the insured's death, the trust should receive death benefit proceeds income-tax-free and estate-tax-free. These proceeds can be used to provide liquidity to pay estate taxes by making loans to the decedent's estate or purchasing assets from the estate.
- If the insured has an "incident of ownership" in the life insurance policy at death (or within 3 years prior to death), the death benefit value becomes part of the insured's gross estate. The trust beneficiaries will receive the actual proceeds, but the amount of those proceeds is included in the insured's gross estate value.
- Paying premiums isn't an incident of ownership. However, gift taxes are associated with paying premiums on a life insurance policy that iisn't owned by the premium payor.
- To avoid the three-year look-back rule, the client can gift money to the trust so the trustee can buy the policy from the grantor for its fair market value. Purchasing the policy avoids the look-back rule. Take care to ensure the sale is for the policy's fair market value.
- A dynasty trust can be created in any state however, many states subject a trust to the "Rule Against Perpetuities". This rule forces a trust to end at some point in time. Many states require a trust to end 21 years after the death of the last beneficiary alive when the trust was created. However, this law is governed at the state level, and several states have abolished or relaxed this rule.
- When the "Rule Against Perpetuities" is abolished, the trust doesn't need to end until the last living descendent of the trust creator dies. In this situation, there's potential for the trust never to end.
- Some states have relaxed laws allowing a trust to continue anywhere from 150 to 1,000 years. To take advantage of another state's rules, having at least one trustee with significant powers based in the desired jurisdiction is important. Many times, this is a bank or trust company.
- The client should consider naming a corporate co-trustee because the dynasty trust can continue for many years.

CLIENT COMMENTS TO LOOK OUT FOR

"How can I benefit my grandchildren and the generation after them?"

"Can anything be done to limit estate taxes at each generational level?"

RIGHT QUESTIONS TO ASK

"Since you're having this ILIT set up to hold your life insurance, would you like to see how it can be structured to benefit many generations to come?"

CHARITABLE REMAINDER TRUST

Tax efficient asset transfer for minimal estate taxation

CONCEPT DESCRIPTION

A charitable remainder trust (CRT) is an irrevocable trust designed to turn highly appreciated assets, like stock or real estate, into increased income and reduced current income taxes through tax-efficient asset transfers. When done correctly, these transfers allow clients to minimize estate taxes while leaving substantial gifts to their favorite charities. CRTs may also maximize the estate for heirs.

CLIENT PROFILE

Someone owning a capital asset or real estate who wants to create an income stream and benefit a favorite charity.

HOW A CHARITABLE REMAINDER TRUST WORKS

» The client establishes a CRT.

» The client names beneficiaries of the trust. The client can be an income beneficiary. The charitable institution that inherits the property at the beneficiary's death will be named or a method to determine the charities will be provided.

» The client transfers property to the trust and can receive income as an annuity or unitrust.

- The client can receive a tax deduction equal to the asset's fair market value minus the present value of the payments the income beneficiary receives from the trust.
- The interest rate used to determine the present value is the Internal Revenue Code Section 7520. This rate changes monthly; however, the donor can use the current month's rate or one of the previous two month's rates. A higher rate creates a higher income-tax deduction.

» At the client's death or the end of the specified number of years, the assets in the trust are distributed to the charity. Distribution can also be triggered by the trust assets falling to 10% of the starting value of the gifts made to the trust.

» Distributed income is taxed to the recipient in the following order:

1. Ordinary income
2. Capital gains
3. Other income
4. Principal

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CASE STUDY

The client, age 60, has a $1M capital asset with a basis of $50,000. Selling the capital asset leaves him with a $950,000 gain taxed at 20%. The client feels the net $810,000 could be invested at 8% (giving an annual income of $65,000). You consult with him about setting up a CRT as an alternative to outright sale:

View Fig 1, page 25

- The client receives $65,164 for life (present value = $746,433)
- The client gets a charitable deduction in year one of $253,567 ($1M – $746,433)
- The annuity payout must be at least 5% and no more than 50% of the CRT's fair market value. Additionally, the value of the remainder interest (to charity) must be at least 10% of the initial net fair market value of the capital asset contributed.
- The annuity payment will be taxable to the client as detailed above
- The charity receives the remaining interest
- The client can replace the capital asset value by purchasing life insurance funded (in part) with a charitable deduction and an annual payment

The client receives a similar annual payment by setting up a CRT, as opposed to an outright sale, but also gets a substantial charitable deduction. The CRT will benefit the charity and provide an income tax deduction.The client can use the income-tax deduction to offset the income taxes due and provide a funding source for new life insurance designed to replace the capital asset value for any children.

CLIENT COMMENTS TO LOOK OUT FOR

"How can I best benefit a charity while maintaining income from the asset?"

"I'm thinking about selling an undeveloped piece of real estate. What's the best way to benefit a charity while maintaining income from the sale?"

RIGHT QUESTIONS TO ASK

"Would you be interested in benefiting a charity from the sale of your corporate stock?"

GRANTOR RETAINED ANNUITY TRUST (GRAT)

Strategic asset movement

CONCEPT DESCRIPTION

A Grantor Retained Annuity Trust (GRAT) is often used when transferring highly appreciating or income-producing assets to subsequent generations. It's also effective in planning to terminate premium financing of life insurance, private financing of life insurance, and economic benefit split dollar arrangements. The trust pays a fixed annuity to the grantor for a defined period.

CLIENT PROFILE

A high-net-worth client with income-producing assets that can be transferred to a newly established trust, thus removing the asset from the estate in a gift-tax-efficient manner. Clients with existing or are contemplating split-dollar loan arrangements (private financing) or premium financing arrangements who are looking for an exit/repayment strategy.

HOW A GRAT WORKS

» The client (grantor) creates an irrevocable trust.

» The client transfers/gifts highly-appreciating or income-producing assets to the trust and retains the right to an annuity payment for a specified term (or for the shorter of a specified term or life).

- To determine the gift tax value, subtract the present value of the annuity interest retained by the grantor from the assets' value at the date of the gift.
- A GRAT is intended to be a qualified interest, so the valuation rules of §2702 don't apply. If these rules apply, the gift tax value would be the total value of the transferred assets.
- The gift doesn't qualify for the annual exclusion amount to shield any gift tax consequences associated with a GRAT because the beneficiary has a future, not present, right to the asset.

» The assets remaining in the trust automatically go to the beneficiary after the annuity period ends. The remaining assets will consist of:

- The assets initially transferred to the trust

PLUS

- The appreciation earned on those assets

PLUS

- The income produced by those assets

MINUS

- The annuity paid to the grantor

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CASE STUDY

The client owns an LLC interest in a rapidly growing family business valued at $1.0M and an annual income of $100,000 (10%). The client would like to transfer the LLC interest to a GRAT to help fund the repayment of the premium financing established one year ago.

The client's attorney sets up a GRAT, and the irrevocable life insurance trust (ILIT) holding his life insurance policy is the beneficiary. He funds the GRAT with $1.0M of the LLC interest and receives the required annual payments. The attorney established a zeroed-out GRAT with a gift tax of $ .04.

View Fig 2, page 25

Client receives $133,304.89 each year (present value = $ 999,999.96)

- The GRAT earns 10% annually
- The remaining interest passing to the ILIT is $469,205.81

The client used the LLC interest to fund his ILIT with $469,205, which will help pay interest on the premium financing and also help repay the loan. The client received the LLC interest back over ten years plus an extra $333k.

CLIENT COMMENTS TO LOOK OUT FOR

"I'm searching for ways to pay the interest and principal on my premium financed policy."

"I need to find a way to repay my private split-dollar loan arrangement."

RIGHT QUESTIONS TO ASK

"I see you have a premium financed loan arrangement for this policy. How do you intend to pay the interest and repay the principal?"

"Are you interested in transferring some of the appreciation on your business holdings with little gift-tax exposure?"

SALE TO A GRANTOR TRUST

Growing trust assets without tax implications

CONCEPT DESCRIPTION

Grantor Trusts are designed with the income attributed to the grantor instead of the trust. Irrevocable grantor trusts are often used when transferring highly appreciating or income-producing assets to keep them out of the estate. For this planning technique, the irrevocable trust used is known as an Intentionally Defective Irrevocable Trust (IDIT). The “defect” in the trust is an intentional provision that causes income to flow back to the trust’s grantor — qualifying the trust for grantor income-tax treatment while also removing the assets for estate tax purposes. By paying the taxes on the trust income, the grantor allows the trust assets to grow without being reduced by taxes.

CLIENT PROFILE

Typically, a high-net-worth client whose income-producing asset can be transferred to a newly established trust, removing the asset from the estate in a gift tax efficient manner. Often, the asset sold to the trust is a business interest.

HOW A SALE TO A GRANTOR TRUST WORKS

1. An irrevocable trust is drafted so that the grantor is considered the trust owner for income tax purposes but not for gift and estate tax purposes.
2. The grantor makes a gift of cash and/or assets to the trust. (The IDIT must be “seeded” or otherwise made a viable borrower — adequate “seeding” may be between 10% and 20% of the value of the property sold). Do this using annual gift exclusions or the client’s gift tax exemption.
3. After gifting, the client sells assets to the trust in exchange for an installment note payable over a specified time period. The note must bear an adequate rate of interest based on the note’s duration — based on the applicable federal rate (short-term, mid-term, or long-term) in effect at the date of the note.
4. The assets sold to the IDIT will hopefully provide sufficient income to cover the debt service. Any excess income can be added to the trust principal or expend it for other uses (i.e., paying premiums).
5. The assets remaining in the trust remain there or can go to the beneficiary after the note is repaid.

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CASE STUDY

The client owns a limited partner interest (LPI) in a rapidly growing family limited partnership with a non-discounted value of $1.5M and an annual income of $180,000 (12% of $1.5M). The discount (assume 33% for lack of marketability and lack of control) associated with the transfer reduces the value to $1M. The client wants to transfer the LPI to an irrevocable trust to benefit his children.

An attorney sets up a new irrevocable trust classified as a grantor trust with the client's children as the trust beneficiaries. He gifts 10% of the discounted LPI ($100,000) to the trust and sells his remaining LPI ($900,000, discounted) to the trust for a ten-year note at the then-current AFR (assume 5.03%).

View Fig 3, page 25

- The client reports a $100,000 gift in year one
- The client reports Income of Trust as his taxable income each year (he pays the income tax so he doesn't need to make additional gifts, and the trust can pay its own income taxes)
- The client receives Payment on Note (principal and interest on the discounted asset sale)
- The trust owns 100% of the LPI plus the growth on the LPI after ten years

The client repositions the highly appreciating asset outside his estate for very little gift tax consequence. Not only is the asset outside the estate, but all future appreciation is outside the estate. The irrevocable trust now owns the income-producing asset. This income-producing asset can be used to pay premiums on a life insurance policy owned by the trust (additional gifting to the trust shouldn't be necessary).

CLIENT COMMENTS TO LOOK OUT FOR

"I'm seeking ways to reduce my overall estate tax exposure."

"I need to fund a life insurance trust but don't have enough annual exclusions to accomplish the gifting."

RIGHT QUESTIONS TO ASK

"Have you reviewed your current estate plan focusing on how to reduce the future size of the estate?"

"Have you considered transferring your business interest into a trust for future generations?"

PRIVATE SPLIT-DOLLAR LOAN

Reducing the gift tax cost of funding a trust-owned life insurance policy

CONCEPT DESCRIPTION

Many wealthy individuals consider purchasing life insurance as part of their overall estate plan. Most of these plans suggest owning the policy via an irrevocable trust (ILIT) to avoid including the policy's death benefit in the estate tax calculation. Gifts to the ILIT need to be limited by the client's annual exclusions ($18,000 in 2024, indexed) or the remaining exemption equivalent ($13.61M in 2024, indexed) to avoid paying gift taxes. If the client wants to conserve their annual exclusion and their exemption equivalent (or has already used both), consider a Private Split-Dollar Loan (PSDL) arrangement to minimize the current gift tax consequences of paying a large premium policy.

A PSDL arrangement isn't a particular type of life insurance policy. It's a private premium financing arrangement entered into between two private parties. One party loans money equal to the life insurance premiums in exchange for a promissory note securing the loan. This arrangement is designed to reduce the annual gift for premium paying purposes to the interest cost (instead of the premium cost) associated with the outstanding loan balance. This should be a small fraction of the overall premium payment(s).

CLIENT PROFILE

A high net-worth client needing to purchase a life insurance policy inside an irrevocable trust for estate liquidity planning. Someone who wants to use the bulk of their annual exclusions and/or exemption equivalent for something other than ILIT-owned life insurance premium payments

HOW PSDL WORKS

- The insured creates an ILIT to purchase and own life insurance and then gifts funds to the ILIT. The gifts can be gift-tax-free depending upon the insured's ability to use annual exclusions gifts and/or exemption equivalents. These gifts can be used to pay the annual interest cost on the outstanding loan balance or pay a portion of the policy's premium requirement.
- The client, spouse, or other related party and ILIT trustee enter into a PSDL agreement which details the rights and responsibilities of each party. The lender (client, spouse, or other) provides either a one-time or a series of loans for the trustee to pay the life insurance premiums. The trustee provides a collateral assignment in favor of the lender to secure their interest in the policy/arrangement.
- The payment, accrual, or imputation of interest is calculated annually.
- The outstanding loan balance can be repaid during the insured's lifetime or can be maintained until death.

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CASE STUDY

After going through an estate planning/tax analysis, it's determined that a married couple needs approximately $20M in life insurance coverage with the policy owned by an ILIT. The premium required to fund the policy is $1,019,937 annually for five years, an amount that far exceeds their available annual exclusions, and they're using their exemption equivalent for other transfers.

You suggest a PSDL arrangement to reduce the gift tax costs of funding the ILIT. The arrangement will assume all five premium amounts are loaned to the ILIT, and the annual interest generated by the arrangement will be accrued each year. The outstanding loan balance will be repaid via the death benefit proceeds when received by the ILIT.

View Fig 4, page 26

- $1,019,937 is loaned to the ILIT annually for five years
- The annual interest cost will be accrued for the duration of the loan arrangement
- The loan balance will be repaid when the ILIT receives the death benefit proceeds

All gift tax costs of establishing funding of the ILIT-owned policy are covered through the PSDL:

- The transfer of amounts to pay the policy premiums aren't considered a taxable gift since they're classified as a loan (as evidenced by the PSDL agreement, a Promissory Note, and Collateral Assignment)
- The annual interest costs aren't considered a gift to the ILIT since the amount is accrued to the loan principal annually
- There are no gift tax costs associated with this high premium policy funding through the proper use of a PSDL arrangement

CLIENT COMMENTS TO LOOK OUT FOR

"How can I fund my ILIT without using so much of my annual exclusions and exemption equivalent?"

"Is there a way to reduce the gift taxes associated with funding a large premium life insurance policy?"

RIGHT QUESTIONS TO ASK

"Would you like to reduce the gift tax impact of funding a large premium life insurance policy?"

NONQUALIFIED ANNUITY MAXIMIZATION STRATEGY

Annuity Max to benefit future generations

CONCEPT DESCRIPTION

Annuity Max is an estate planning technique for transforming the value in a nonqualified annuity into a more transfer-tax efficient arrangement to better benefit subsequent generations. Annuities are subject to two taxes when they transfer to subsequent generations:

- Estate tax to the extent the client is in an estate tax position
- Income tax when the beneficiaries take distributions from the inherited annuity

An irrevocable life insurance trust (ILIT) and a fully funded life insurance policy is a more transfer-tax efficient arrangement.

CLIENT PROFILE

Annuity owners who don't need the annuity or a portion of the annuity for retirement income. An annuity owner who would prefer to pass the annuity value to subsequent generations.

HOW ANNUITY MAX WORKS

- » The client takes annual distributions from the annuity (over ten years, for example) or annuitizes (over ten years, for example)
- » The client pays income tax on annual distributions
- » The client gifts the net (after-tax) distribution to an ILIT designed to hold a life insurance policy
- » ILIT trustee uses annual gifts to pay the life insurance premiums (set up as a ten pay)
- » The annuity reduces to zero — the ILIT-owned life insurance replaces it with income- and estate-tax free proceeds

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CASE STUDY

The client has a $2M nonqualified annuity she won't need for retirement income. You consult with her about a strategy for the annuity to transfer to her children at death. You tell her that the annuity is included in her estate, causing her to owe additional estate taxes. Also, distributions from the annuity are taxable to her children when received. This double taxation can cause the annuity to lose substantial value:

- Annuity taxable in her estate (40%): $2M X .40 = $800,000 {Estate Taxes Owed}
- Annuity taxable to her children (30%): $2M X .30 = $600,000 {Income Taxes Owed assuming no basis in the annuity}

Once she learns the total taxes on transferring the annuity to her children will approximate $1.4M, she asks you for an alternative.

View Fig 5, page 27

- The client takes $246,670 annually for ten years. The after-tax distribution is $172,669
- The client gifts $172,669 to an ILIT annually for ten years
- The trustee pays the annual premium
- Survivor policy has a face amount of $5.2M
- At year 11, the IRA is drained and the life policy is fully funded

The client uses an Annuity Max strategy to change a double taxation annuity into a transfer-tax efficient plan. The $2M annuity (which would have caused $1.4M in taxes) is transformed into a $5.2M life insurance policy that isn't subject to income or estate taxes.

CLIENT COMMENTS TO LOOK OUT FOR

"I've overfunded my retirement and want my annuity to benefit my children."

"I'm concerned about income taxes for my children when they inherit my annuity."

RIGHT QUESTIONS TO ASK

"We've calculated that your annuity isn't needed for retirement funding. Are you aware of the double-tax consequences with an annuity that happens when you die?"

"Would you like to leave more of your annuity to your children and grandchildren?"

IRA MAXIMIZATION STRATEGY

IRA Max to address double taxation situations

CONCEPT DESCRIPTION

IRA Max is an estate planning technique for transforming the value in an IRA into a more transfer-tax efficient arrangement to better benefit subsequent generations. IRAs are subject to two taxes when they transfer to future generations:

- Estate tax to the extent the client is in an estate tax position
- Income tax when the beneficiaries take distributions from the inherited IRA

A more transfer-tax efficient arrangement suggests an irrevocable life insurance trust (ILIT) and a fully funded life insurance policy.

CLIENT PROFILE

An IRA owner who doesn't need the IRA or a portion of the IRA for retirement income. An IRA owner who prefers to pass the IRA value to subsequent generations.

HOW IRA MAX WORKS

» The client takes annual distributions from the IRA (over ten years, for example)

» The client pays the income tax on annual distributions

» The client gifts the net (after-tax) distribution to an ILIT designed to hold a life insurance policy on client(s)

» ILIT trustee uses annual gifts to pay life insurance premiums (set up as a ten pay)

» IRA reduces to zero — ILIT owned life insurance replaces it with income- and estate-tax free proceeds

Key Selling Points

- Many states impose transfer taxes. These taxes are generally imposed at lower rates than the federal transfer tax rates. Any amounts paid to the state for transfer taxes are allowed as deductions in determining the federal tax.
- Transferring of life insurance policies to remove the excess of the death benefit over the value at the date of gift from the estate is common and often very tax efficient. Transfers of annuities are typically considerably less tax-efficient.
- The basis for determining gain typically varies depending on whether the property is received by gift or inheritance.
- Although gifts and transfers at death are part of a unified system, one may produce better results than the other, depending on the situation.

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CASE STUDY

A married couple has a $2M traditional IRA they won't need for retirement income and they don't want required required minimum distributions (RMDs) in the coming years. Their preference is to transfer the IRA to their children upon their death. You tell them the IRA will be included in their estate causing additional estate taxes to be owed. Also, the distributions from the IRA are income-taxable to their children when received. This double taxation can cause the IRA to lose substantial value:

- IRA taxable in their estate (40%): $2M X .40 = $800,000 {Estate Taxes Owed}
- IRA taxable to their children (30%): $2M X .30 = $600,000 {Income Taxes Owed}

Once they learn the total taxes on transferring the IRA to their children will approximate $1.4M, they ask you for an alternative.

View Fig 6, page 27

- The client takes $246,670 annually for ten years. The after-tax distribution is $172,669
- The client gifts $172,669 to an ILIT annually for ten years
- The trustee pays the annual premium
- The survivor policy has a face amount of $5.2M
- At year 11 the IRA is drained and the life policy is fully funded

The client uses an IRA Max strategy to change the double taxation IRA into a transfer tax efficient plan. The $2M IRA (which would have caused $1.4M in taxes) is transformed into a $5.2M life insurance policy (which isn't subject to income or estate taxes). Plus the client is also able to eliminate any future RMDs.

CLIENT COMMENTS TO LOOK OUT FOR

"I've overfunded my IRA and want it to benefit my children"

"I'm concerned about RMDs since I don't need them"

RIGHT QUESTIONS TO ASK

"Since your IRA isn't needed for retirement funding, have you considered the double tax consequences of dying with an IRA?"

"Would you like to give more of your IRA to your children and grandchildren?"

CHARITABLE GIVING WITH LIFE INSURANCE

Multiple giving options based on intentions and outcomes

CONCEPT DESCRIPTION

There are a number of ways to fund charitable giving programs, but none offer the unique advantages and the flexibility of life insurance.

Typically, the amount of a policy's death benefit far surpasses the total of premiums paid, resulting in leveraged dollars. Rather than making annual donations to help fund their charities' missions, it's possible to leave amounts large enough to make a serious impact in the planning goals of their chosen charity.

CLIENT PROFILE

A client with philanthropic goals who wants an income-tax deduction. A client who intends to leave a large charitable legacy.

OPTIONAL WAYS CHARITABLE GIVING WORKS

1. Gifting insurance policy dividends to a charity

With an older dividend-paying whole life insurance contract, this strategy is easy to implement. All that is necessary is to contact the insurance company and request the policy dividends to be paid in cash, and then donate those dividends to a charity. These cash gifts can be deductible up to 50 percent of their adjusted gross income.

2. Change the current beneficiary to a charity

This is also easily accomplished. A favorite charity is named as the beneficiary for either all or a portion of the policy proceeds. The ownership of the policy does not change and the beneficiary designation is revocable at any time. There is no income tax deduction for premiums paid on this policy, but it qualifies for a full charitable estate tax deduction for the proceeds.

3. Give an existing policy to a charity

This is for policies that are no longer needed. Perhaps a policy was purchased when the children were small, or before the mortgage was paid in full. Gifting these policies to charity effectively reduces the taxable estate. In addition, an income tax deduction is generally available for the lesser of the cost basis or the fair market value of the contract. Caution needs to be exercised when there is a policy loan on the contract and the tax advisor and the charity should be consulted prior to transferring ownership.

4. Buy a new policy and make gifts so it can pay the premiums

This can provide a very large gift in proportion to the amount gifted to the charity. The gifts to pay the premiums should provide current tax deductions as long as there are "no strings" attached to the gifts.

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5. Buy life insurance to replace the value of an asset donated to charity

Donating highly appreciated assets to charity can provide income and estate tax benefits, but can reduce the amounts left to heirs. To overcome this, the value of the donated assets can be replaced with life insurance so heirs can receive the inheritance income tax free. If the policy is purchased inside a wealth replacement trust, the death benefit can alsobe estate tax free.

6. Buy life insurance to back a pledge or future donation to charity

Pledging a large amount to a hospital can mean a lot to both the charity and the donor. An efficient way to ensure payment of a future donation or pledge is by purchasing life insurance and naming that charity as the beneficiary. Life insurance provides a low-cost way to provide a large benefit to charity. As the pledge is paid off, the charity can be left as beneficiary of the entire life policy, or a portion of the proceeds redirected to heirs or another charity.

THE BOTTOMLINE

An outright gift of a life insurance policy generally will produce a charitable income tax deduction equal to the lesser of the policy's value or the donor's basis in the policy. Usually the donor's basis in a policy equals the total amount of premiums paid by the donor. As a practical matter, the charitable income tax deduction will normally equal the donor's basis because, in most instances, the cost basis will not be greater than the policy's value, i.e., replacement cost or Interpolated Terminal Reserve Value.

CLIENT COMMENTS TO LOOK OUT FOR

"I'm searching for ways to benefit my charity beyond annual giving."

"What should I do with my existing life insurance policy now that it's not needed?"

RIGHT QUESTIONS TO ASK

"Would you like to donate your life insurance policy, which you no longer need, to charity and receive a current income-tax deduction?"

ASSOCIATED CHARTS AND NUMBERS

FIG 1, PAGE 12 CHARITABLE REMAINDER TRUST

YEAR	BEGINNING PRINCIPAL	8.00% GROWTH	PAYMENT	REMAINDER
1	1,000,000.00	80,000.00	65,164.53	1,014,835.47
2	1,014,835.47	81,186.84	65,164.53	1,030,857.78
3	1,030,857.78	82,468.62	65,164.53	1,048,161.87
4	1,048,161.87	83,852.95	65,164.53	1,066,850.29
5	1,066,850.29	85,348.02	65,164.53	1,087,033.78
6	1,087,033.78	86,962.70	65,164.53	1,108,831.95
19	1,555,591.98	124,447.36	65,164.53	1,614,874.81
20	1,614,874.81	129,189.98	65,164.53	1,678,900.26
21	1,678,900.26	134,312.02	65,164.53	1,748,047.75
Summary	1,000,000.00	2,116,502.88	1,368,455.13	1,748,047.75

FIG 2, PAGE 14 GRANTOR RETAINED ANNUITY TRUST

	ECONOMIC SCHEDULE					
YEAR	BEGINNING PRINCIPAL	0.00% GROWTH	10.00% ANNUAL INCOME	REQUIRED PAYMENTS	DISTRIBUTED DISCOUNT	REMAINDER
1	1,000,000.00	0.00	100,000.00	133,304.89	0.00	966,695.11
2	966,695.11	0.00	96,669.51	133,304.89	0.00	930,059.73
3	930,059.73	0.00	93,005.97	133,304.89	0.00	889,760.81
4	889,760.81	0.00	88,976.08	133,304.89	0.00	845,432.00
5	845,432.00	0.00	84,543.20	133,304.89	0.00	796,670.31
6	796,670.31	0.00	79,667.03	133,304.89	0.00	743,032.45
7	743,032.45	0.00	74,303.24	133,304.89	0.00	684,030.80
8	684,030.80	0.00	68,403.08	133,304.89	0.00	619,128.99
9	619,128.99	0.00	61,912.90	133,304.89	0.00	547,737.00
10	547,737.00	0.00	54,773.70	133,304.89	0.00	469,205.81
Summary	1,000,000.00	0.00	802,254.71	1,333,048.90	0.00	469,205.81

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ASSOCIATED CHARTS AND NUMBERS

FIG 3, PAGE 16 SALE TO GRANTOR TRUST

YEAR	BEGINNING PRINCIPAL	INCOME OF TRUST	PAYMENT ON NOTE	ENDING PRINCIPAL
1	1,500,000	150,000	116,724	1,533,276
2	1,533,276	153,328	116,724	1,569,880
3	1,569,880	156,988	116,724	1,610,144
4	1,610,144	161,014	116,724	1,654,434
5	1,654,434	165,443	116,724	1,703,153
6	1,703,153	170,315	116,724	1,756,745
7	1,756,745	175,674	116,724	1,815,695
8	1,815,695	181,570	116,724	1,880,541
9	1,880,541	188,054	116,724	1,951,871
10	1,951,871	195,187	116,724	2,030,334

FIG 4, PAGE 18 PRIVATE SPLIT-DOLLAR LOAN

YEAR	M/F AGES	(1) Gift to Trust for Premium	(2) Loan to Trust for Premium	(3) Year End Balance of Loan Including Accrued Loan Interest	(4) Year End Policy Accum Value	(5) Year End Policy Surrender Value	(6) Year End Policy Surrender Value Net of Loan	(7) Year End Policy Death Benefit Net of Loan
1	55/54	0	1,019,937	1,042,478	896,547	387,484	-654,994	24,854,069
2	56/55	0	1,019,937	2,107,994	1,848,659	1,384,971	-723,023	24,740,665
3	57/56	0	1,019,937	3,197,058	2,859,487	2,442,487	-754,571	24,662,429
4	58/57	0	1,019,937	4,310,191	3,932,331	3,563,144	-747,047	24,622,140
5	59/58	0	1,019,937	5,447,924	5,070,548	4,750,298	-697,626	24,622,624
6	60/59	0	0	5,568,323	5,380,640	5,110,452	-457,871	24,502,225
7	61/60	0	0	5,691,383	5,706,071	5,487,258	-204,125	24,379,165
8	62/61	0	0	5,817,163	6,050,250	5,884,125	66,962	24,253,385
9	63/62	0	0	5,945,722	6,414,159	6,302,034	356,312	24,124,826
10	64/63	0	0	6,077,122	6,798,775	6,741,963	664,841	23,993,426
11	65/64	0	0	6,211,426	7,229,591	7,229,591	1,018,165	23,859,122
12	66/65	0	0	6,348,699	7,685,940	7,685,940	1,337,241	23,721,849
13	67/66	0	0	6,489,005	8,168,385	8,168,385	1,679,380	23,581,543
14	68/67	0	0	6,632,412	8,677,952	8,677,952	2,045,540	23,438,136
15	69/68	0	0	6,778,988	9,217,065	9,217,065	2,438,077	23,291,560

ASSOCIATED CHARTS AND NUMBERS

FIG 5, PAGE 20 NONQUALIFIED ANNUITY MAX

FINANCIAL INDEPENDENCE GROUP
Qualified or IRA Money Transfer Maximization

Valued Husband (67) and Wife (67)
Standard Nontobacco

Assumed Rate on Earnings: 5.00%
Clients and Beneficiary Tax Rate: 30%

	QUALIFIED PLAN OR IRA ACCOUNT							NEW LIFE INSURANCE POLICY OWNED BY IRREVOCABLE TRUST				
AGE	BEGINNING BALANCE	GROSS DISTRIBUTION (BOY)	EARNINGS	AFTER TAX DISTRIBUTION	ENDING BALANCE	ESTATE TAX OWED BY ESTATE	BENEFICIARY NET ACCOUNT RECEIVED (IRD)	PREMIUM	CASH SURRENDER VALUE	POLICY DEATH BENEFIT	ESTATE TAX OWED BY ESTATE	BENEFICIARY NET AMOUNT RECEIVED (IRD)
			5.0%	30.0%		40.0%	30.0%				40.0%	30.0%
67	2,000,000	246,670	87,667	172,669	1,840,997	736,399	1,288,698	172,669	85,872	5,235,841	0	5,235,841
68	1,840,997	246,670	79,716	172,669	1,674,043	669,617	1,171,830	172,669	245,296	5,235,841	0	5,235,841
69	1,674,043	246,670	71,369	172,669	1,498,741	599,497	1,049,119	172,669	413,569	5,235,841	0	5,235,841
70	1,498,741	246,670	62,604	172,669	1,314,675	525,870	920,273	172,669	591,107	5,235,841	0	5,235,841
71	1,314,675	246,670	53,400	172,669	1,121,405	448,562	784,984	172,669	778,350	5,235,841	0	5,235,841
72	1,121,405	246,670	43,737	172,669	918,472	367,389	642,930	172,669	975,604	5,235,841	0	5,235,841
73	918,472	246,670	33,590	172,669	705,392	282,157	493,775	172,669	1,183,275	5,235,841	0	5,235,841
74	705,392	246,670	22,936	172,669	481,658	192,663	337,161	172,669	1,401,708	5,235,841	0	5,235,841
75	481,658	246,670	11,749	172,669	246,738	98,695	172,716	172,669	1,631,196	5,235,841	0	5,235,841
76	246,738	246,670	3	172,669	71	28	50	172,669	1,872,048	5,235,841	0	5,235,841
77	71	71	0	50	0	0	0	0	1,975,706	5,235,841	0	5,235,841

FIG 6, PAGE 22 IRA MAXIMIZATION

FINANCIAL INDEPENDENCE GROUP
Qualified or IRA Money Transfer Maximization

Valued Husband (67) and Wife (67)
Standard Nontobacco

Assumed Rate on Earnings: 5.00%
Clients and Beneficiary Tax Rate: 30%

	QUALIFIED PLAN OR IRA ACCOUNT							NEW LIFE INSURANCE POLICY OWNED BY IRREVOCABLE TRUST				
AGE	BEGINNING BALANCE	GROSS DISTRIBUTION (BOY)	EARNINGS	AFTER TAX DISTRIBUTION	ENDING BALANCE	ESTATE TAX OWED BY ESTATE	BENEFICIARY NET ACCOUNT RECEIVED (IRD)	PREMIUM	CASH SURRENDER VALUE	POLICY DEATH BENEFIT	ESTATE TAX OWED BY ESTATE	BENEFICIARY NET AMOUNT RECEIVED (IRD)
			5.0%	30.0%		40.0%	30.0%				40.0%	30.0%
67	2,000,000	246,670	87,667	172,669	1,840,997	736,399	1,288,698	172,669	85,872	5,235,841	0	5,235,841
68	1,840,997	246,670	79,716	172,669	1,674,043	669,617	1,171,830	172,669	245,296	5,235,841	0	5,235,841
69	1,674,043	246,670	71,369	172,669	1,498,741	599,497	1,049,119	172,669	413,569	5,235,841	0	5,235,841
70	1,498,741	246,670	62,604	172,669	1,314,675	525,870	920,273	172,669	591,107	5,235,841	0	5,235,841
71	1,314,675	246,670	53,400	172,669	1,121,405	448,562	784,984	172,669	778,350	5,235,841	0	5,235,841
72	1,121,405	246,670	43,737	172,669	918,472	367,389	642,930	172,669	975,604	5,235,841	0	5,235,841
73	918,472	246,670	33,590	172,669	705,392	282,157	493,775	172,669	1,183,275	5,235,841	0	5,235,841
74	705,392	246,670	22,936	172,669	481,658	192,663	337,161	172,669	1,401,708	5,235,841	0	5,235,841
75	481,658	246,670	11,749	172,669	246,738	98,695	172,716	172,669	1,631,196	5,235,841	0	5,235,841
76	246,738	246,670	3	172,669	71	28	50	172,669	1,872,048	5,235,841	0	5,235,841
77	71	71	0	50	0	0	0	0	1,975,706	5,235,841	0	5,235,841

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