10 Reasons Why Wealthy Individuals and Families Buy Life Insurance

1 Dynasty Trust

Dynasty trusts are multi-generational irrevocable trusts established by ultra-high-net-worth families ($50 million +) who want to pass their wealth to future generations while minimizing confiscatory transfer taxes. In some cases the Dynasty Trust is established to inspire entrepreneurship in future generations, serving as a “family bank” to fund start-up companies of family members. In other cases, the Dynasty Trust serves as the source of educational funds for future generations of family members.

Life Insurance Solution:

Dynasty Trusts are often formed for the purpose of owning, among other assets, life insurance insuring the life of the trust grantor, the grantor’s spouse, or the joint lives of such parties. The purchase of life insurance through a Dynasty Trust allows the grantor to leverage the use of the Unified Credit and the Generation Skipping Transfer tax exemptions since policy premiums are significantly lower than the policy’s death benefit.

2 Federal Estate Tax

Under current law, federal estate tax may be applicable to a client with a net worth in excess of $11.7 million or $23.4 million for married couples.

Life Insurance Solution:

To provide the liquidity to pay any estate taxes, clients may choose to buy life insurance. The client typically establishes an irrevocable life insurance trust ("ILIT") to hold the insurance so that it is not included in their estate for estate tax purposes. Survivorship life insurance may be an attractive solution for such purpose because generally survivorship life insurance is less expensive than insurance insuring only one life. In addition, survivorship life insurance pays a benefit after the second spouse passes away, which is typically when federal estate taxes apply.

3 State/Estate/ Inheritance Tax

State estate taxes and/or inheritance taxes imposed on the beneficiary's inheritance reduce the amount that heirs receive.

Life Insurance Solution:

Clients often choose to purchase life insurance to help offset the cost of inheritance taxes because the policy death benefit is income-tax free (according to IRC 101(a)). Often, the life insurance is purchased by an irrevocable life insurance trust ("ILIT") to keep the insurance policy outside the clients’ taxable estate. However, in some cases, the client may choose to own the policy outright.

4 Enhancing Gifts to Children & Grandchildren

Clients may want to leave a larger inheritance to their children and grandchildren. How do they maximize and protect the amounts they wish to leave?

Life Insurance Solution:

Life insurance may be used to enhance a gift to children or grandchildren. The clients may choose to gift money to a trust. In turn, the trust purchases the life insurance policy on the parent or parents’ lives. Generally, notwithstanding the time value of money, the gift that had been given to the trust and used to purchase the life insurance policy will be lower than the amount that will be paid out as the death benefit. By having the trust purchase the life insurance policy, the clients are able to leave a larger gift to their heirs.

5 Children Not Party to Business Succession Planning

One child may have worked in a small family business while another child may be interested in doing something else. In such a situation, clients may give the family business to the child who is involved in the business and may wish to equalize the inheritance for the other child.

Life Insurance Solution:

Similar to estate equalization (see below), life insurance may be a useful way to fund a gift to a child or children who are not party to business succession planning. The death benefit can provide monetary value equivalent to the business, thereby giving all heirs an equal inheritance. This is a useful solution for clients regardless of their net worth.

6 Estate Equalization

Estate equalization may be an issue. For example, one child may live close to home, while another child lives far away. In such a situation, the client may give a house or a parcel of land to the child living close to home, and may wish to equalize the inheritance for the child who moved away.

Life Insurance Solution:

Life insurance may be used in these situations by providing a death benefit inheritance to the child or children who moved away. The death benefit can provide monetary value equivalent to the gifted home or land, thereby allowing all heirs share equally.

7 Stabilize Wealth for Clients with Concentrated Stock

Clients who have a disproportionately large stock position in one particular company are exposed to company-specific risk and stock price volatility. As the stock market fluctuates up and down so does the price of the stock. Often clients have no other non-correlated assets to offset this volatility.

Life Insurance Solution:

Including life insurance as part of the client’s overall portfolio helps the client to leverage some of their assets to create wealth for the next generation, while helping to diversify their portfolio for their heirs. Life insurance can provide: (1) a non-correlated death benefit for the client’s beneficiaries; (2) increased predictability; (3) reduced exposure to price volatility on the concentrated stock; and (4) tax advantages that could help leave more money to the beneficiaries.

8 Income in Respect of Decedent (IRD)

When an heir inherits an IRA or 401(k) retirement plan, the heir must pay income taxes on the monies when received. Those monies are considered Income in Respect of Decedent ("IRD"). The IRD taxation issue is a problem for many.

Life Insurance Solution:

Clients may choose to purchase a life insurance policy to provide additional funds to their heirs, when they need it most, in order to help offset the impact of IRD taxes upon their heirs. The income-tax-free death benefit from the life insurance policy can be used to pay the IRD taxes.

9 Special Needs Planning

When a family has a child with special needs and one parent dies, the other parent will need to continue to care for the child while funding the child’s special lifestyle.

Life Insurance Solution:

A life insurance policy’s death benefit may be able to help provide for that child’s needs. Generally, for clients with special needs children, special needs planning typically refers to the necessity of establishing a trust for children who have disabilities, special medical needs, or other special needs. Clients should consult with an attorney who has experience in special needs planning to ensure that the trust is properly drafted to provide assistance to the special needs child without negatively impacting the child’s right(s) to available services.

10 Charitable Giving

Some clients want to leave a charitable legacy, but want to minimize the impact on their children’s inheritance.

Life Insurance Solution:

Life insurance may be selected as a way to fund a charitable gift. The clients may own a life insurance policy and name the charity as policy beneficiary. After the death of the insured, the policy would pay some or all of the death benefit to the charity. As an alternative, the client may gift the premium to the charity on a periodic basis. The charity, in turn, would be the owner and beneficiary of the policy and use the client gifts to pay the premium.

For federal income tax purposes, life insurance death benefits are generally paid 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).