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Maximizing The Estate Planning Value of Life Insurance

Knowledge Series - Part Three

Maximizing the Estate Planning Value of Life Insurance

What is maximizing the estate planning value of life insurance? Simply put, maximizing the estate planning value of life insurance means getting the most bang for your buck. That is, it involves keeping as much of the proceeds as possible away from the IRS and in the hands of your client's beneficiaries. When your client dies, all his or her worldly goods (e.g., money, house, car, stocks, bonds, as well as life insurance proceeds) become a pie. The pie is then cut into slices and served. One slice goes to your client's heirs and beneficiaries, one slice to the federal government, one slice to your client's creditors, and so on. The size of the slice that goes to the federal government can be as big as 40 percent (the rate for the estates of persons who die in 2013 and later years), and what goes to the federal government does not go to your client's heirs and beneficiaries. Your client needs to plan now to make sure that the slice that goes to the federal government is as small as possible, leaving a bigger slice for your client's loved ones.

Arrange proper ownership of the policy. Who owns the policy and for how long can affect how life insurance is taxed for estate tax purposes. If your client owns a life insurance policy, the proceeds of the policy are includable in your client's gross estate for estate tax purposes, regardless of who your client's designated beneficiaries are. If your client owns a policy and transfer it to another owner within three years of your client's death, the transfer is not recognized for estate tax purposes and the proceeds are therefore includable in your client's gross estate. However, if your client transfers ownership of the policy to someone else more than three years before your client's death, the transfer is recognized for estate tax purposes and the proceeds will therefore not be included in your client's estate. Since insurance that your client owns at death (or within three years of death) is included in your client's estate and therefore may be subject to estate tax, someone other than your client should own the policy if your client wishes to avoid subjecting the proceeds to estate tax. The owner of the policy can be another

individual or a trust such as an irrevocable life insurance trust (ILIT).

Designate the right beneficiary. Who your client's beneficiaries are can also affect how life insurance is taxed for estate tax purposes. For example, if the designated beneficiary of a policy on your client's life is your client's estate, the proceeds are generally includable in your client's gross estate for estate tax purposes even if your client did not own the policy at death (or did not own it within three years of death). If the designated beneficiary is your client's executor or your client's estate, the proceeds may be includable in your client's gross estate.

The primary reason for not naming the estate or executors as beneficiaries of policies on life insurance is that doing so subjects the proceeds to the expense of probate and claims of creditors. If your client owns the policy and name a third party as a beneficiary, the proceeds will be included in your client's estate for estate tax purposes but they will pass by operation of law outside of the probate process and will not be subject to the claims of creditors of your client's estate. Proceeds payable to your client's children are not subject to estate tax unless your client owns the policy at death or within three years of death. If your client owns the policy, the proceeds are includable in your client's estate (and therefore subject to the estate tax) regardless of who your client's beneficiaries are.

However, as noted above, if your client names his or her children as beneficiaries, they will receive a greater benefit from the policy than if your client named his or her estate as the beneficiary and then directed that the proceeds be distributed from the estate to your client's children, because proceeds paid to your client's estate will be reduced by probate expenses and claims of creditors while proceeds paid directly to your client's children will not.

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Contact Chad Cardwell, LL.M. for a consultation.

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Information

Chad Cardwell, LL.M. believes in helping clients through processes that can be challenging by giving each matter personal attention, providing sound legal information and having open communication with every client. Attorney Cardwell has dedicated his career to practicing exclusively in the area of estate planning since 2008. Attorney Cardwell was admitted to practice before the Supreme Court of Tennessee in 2007 and the United States Tax Court in 2008, and holds the distinction of being an Accredited Estate Planner® designee by the National Association of Estate Planners and Councils.