The Solution to Estate Tax Planning Fatigue

If you're a high net worth individual, you may have previously been told by your tax and/or legal advisors that you had an estate tax issue. And that this was something that you should address. After all, you pay a lot in income taxes, so you don't want to be subject to estate taxes as well.

In response, you may have amended your Will and possibly created a Revocable Living Trust. You may also have engaged in additional layers of estate tax planning, including gifting strategies, irrevocable trusts, family limited partnerships, or other options.

Years later, you may have been told by those same advisors that you no longer had an estate tax issue. This may have come as a surprise considering that your net worth may have grown but, due to changes in tax laws, your previous planning may have been rendered obsolete. Fast forward a few more years and lo and behold, your estate tax issues have reappeared. Your net worth, however, may have stayed the same or even decreased, again because of changes in tax laws, necessitating additional planning.

This revolving door of having, or not having, an estate tax issue can be blamed on politics and the party controlling the Presidency and Congress at various times in your life. This causes constantly changing tax priorities, policies, laws, and the federal estate tax exemption amount ("exemption amount"). The exemption amount is the aggregate amount that any individual citizen or permanent resident can give away during life and/or at death, to family members and heirs, without federal estate tax consequences. The federal estate tax exemption also takes into consideration lifetime gifts that you may have made. (*To simplify this discussion, we are ignoring potential state estate taxes which may also apply, depending upon residency.*)

For example, in 1997, the exemption amount was $600,000. In 2002, it was raised to $1 million. In 2009, it was raised to $3.5 million. Just a year later, the exemption amount was raised to $5 million. In 2018, that amount was doubled to $10 million with inflation adjustments. In 2026, that amount will automatically revert back to $5 million plus inflation adjustments. It could, of course, happen sooner as proposed by the current Biden Administration. Indeed, there has been much political discussion to lower the exemption amount back to $3.5 million.

This estate tax roller coaster has left many high-net-worth individuals and families with planning fatigue. The fatigue is brought on by the constant struggle to manage their estate tax exposure and the ultimate goal of ensuring that their families and future generations are financially secure and cared for.

Fortunately, there is a relatively simple solution to address this planning fatigue while ensuring that a legacy is left to loved ones. That's through the purchase of life insurance.

Here's A Simple Example:

Joe and Janet are ages 58 and 55. Joe is a senior corporate executive and Janet is an entrepreneur with a successful business. They have adult children, a grandchild on the way, and hope to have many grandchildren in the future. Joe and Janet want to ensure that they are all well cared for in the future. They are at a point in their lives, however, where they're not ready to give away their wealth. In fact, they are still accumulating and growing it. They've sacrificed and worked hard to build their wealth and are looking forward to the time when they can slow down or retire. Joe and Janet have a net worth of approximately $15 million. They feel that they pay a high amount of income taxes each year and would like to pay as little estate tax as possible.

If they both passed away prior to January 1, 2026, they will have no federal estate tax issues. The federal estate tax exemption is inflation adjusted to $12.06 million per person in 2022 (or $24.12 million per married couple). Thus, assuming no further growth, their entire estate of $15 million would be covered by their exemptions with proper basic planning. There would be little if any need to do more complicated planning. Given their ages and good health, however, the likelihood of them both passing before 2026 is remote.

Note that the current federal estate tax rate is 40% but the exemption amount and tax rate could also change in the future. Not long ago, the estate tax rate was as high as 55%.

If they both passed away sometime after December 31, 2025, when the federal estate tax exemption will revert back to $5 million per person, there probably will be estate tax exposure. Without taking inflation or growth of their wealth into account, $5 million of their estate would be subject to federal estate taxes, causing a tax bill of $2 million to the IRS.

If the federal estate tax exemption is brought down to $3.5 million, $8 million of their estate would be exposed to federal estate taxes, causing a tax bill of $3.2 million to the IRS.

	$5 million exemption	$3.5 million exemption	
Net to heirs without life insurance	**Estate $15 million** Less exemptions $10 million Exposure to tax **$5 million** x 40% **Estate tax $2 million** Balance to Heirs $10 million $3 million **$13 million**	**Estate $15 million** Less exemptions $7 million Exposure to tax **$8 million** x 40% **Estate tax $3.2 million** Balance to Heirs $7 million $4.8 million **$11.8 million**	Estate taxes on top of income taxes paid during their lifetimes. Less to enjoy during retirement or less to leave as a family legacy

Joe and Janet decide to buy a second-to-die (aka survivorship) life insurance policy that pays a death benefit after they're both gone. They could have opted to buy individual life insurance policies, but they feel that they have enough wealth so neither spouse would need support because of the death of the other. The survivorship policy would most likely be a more economical option than two single life policies. The survivorship policy would be only about the children, future generations, and estate taxes.

The policy will be held in an irrevocable life insurance trust (ILIT), which is the only advanced planning that is necessary beyond their basic estate planning documents. A properly structured and funded ILIT is necessary to ensure that the insurance proceeds are not counted for estate tax purposes. They purchase a $3 million policy, designed to have an increasing death benefit, because that allows them to address a variety of scenarios including (a) potential exemption decreases in the future; (b) possible tax rate increases, or (c) increases in their net worth, all of which might increase their estate tax burden. The ILIT can also purchase additional insurance in the future, if needed.

With the life insurance, their heirs now receive the value of their full $15 million estate plus an additional $1 million, if the exemption amount remains at $5 million. With an exemption amount of $3.5 million, their heirs will receive nearly their entire $15 million estate. This is all because the life insurance proceeds replace the wealth lost to estate taxes.

	$5 million exemption	$3.5 million exemption	
Net to heirs with life insurance	Estate $15 million Less exemptions <u>$10 million</u> $5 million <u>x 40%</u> Estate tax $2 million Balance to Heirs $10 million $3 million <u>$3 million</u> $16 million	Estate $15 million Less exemptions <u>$7 million</u> $8 million <u>x 40%</u> Estate tax $3.2 million Balance to Heirs $7 million $4.8 million <u>$3 million</u> $14.8 million	More to enjoy during retirement and more to leave as a family legacy

This simple solution would also work if Joe and Janet are worth significantly more, although the insurance amount may need to be increased. It also satisfies the multiple goals that they have:

- **All assets are available to create cashflow to bolster their enjoyment of retirement because the life insurance proceeds will help guarantee a legacy.**
- **Wealth that beneficiaries may lose due to estate taxes is replaced with insurance proceeds.**
- **There is a guaranteed inheritance and legacy amount to beneficiaries through the life insurance death benefit.**
- **If the estate tax exposure is less than anticipated, their beneficiaries are a little better off financially.**
- **If the estate tax exposure is greater than anticipated, they still pass most or all of the value of their wealth to their heirs.**

Conclusion

Life insurance can be used to avoid planning fatigue caused by ever-changing tax laws and political environments. It simplifies the need to constantly implement, change or revise complicated legal strategies to minimize estate tax exposure. The life insurance can be used to help pay estate taxes or replace wealth lost to taxes. It also frees up your assets to enjoy during retirement, knowing that the life insurance proceeds will provide an inheritance to your family members. Additional life insurance may be purchased if the need arises. Simplify your estate tax planning by purchasing life insurance inside of an ILIT.

For More Information Contact:

Contact your Security Mutual Life insurance advisor today to get the process started. Your advisor will assemble your team and coordinate with your attorney and tax professional to review your situation and to determine the estate plan that is appropriate for you.

The information presented is designed to provide general information regarding the subject matter covered. It is not intended to serve as legal, tax or other financial advice related to individual situations, because each person's legal, tax and financial situation is different. Specific advice needs to be tailored to your particular situation. Therefore, please consult with your own attorney, tax professional and/or other advisors regarding your specific situation.

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