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SALES STRATEGY

ESTATE PLANNING | Advanced Markets

Gifting

The Power of Lifetime Giving

The Concerns

Many affluent clients express a desire to provide for their loved ones after they are gone. One of the best ways to provide for family members is by helping clients to plan while they are alive. By establishing a lifetime giving program, a donor can have greater privacy while making gifts, and ensure that the gifts are not subject to the probate process — a process that can delay the transfer of assets to heirs at the donor's death. It is also possible to leverage lifetime gifts with life insurance on the donor's life to increase the amount of the gift.

If estate taxes are a concern, your client may want the life insurance to be owned by an Irrevocable Life Insurance Trust (ILIT).[1]

Tax Benefits of Lifetime Giving

Annual Exclusion Gifts. The gift tax annual exclusion is the maximum amount which a taxpayer can gift each year to any beneficiary without being required to use his or her lifetime exemption amount from gift tax.[2] If gifts are limited each year to this annual exclusion amount, the person making the gift is not required to file a gift tax return, and no gift taxes will be due. The amount of the annual exclusion in 2014 is $14,000. The gift tax annual exclusion amount may be adjusted annually based on cost-of-living increases in the Consumer Price Index.

Lifetime Gift Exemption. In *addition* to the annual exclusion, each person can also gift their lifetime exemption. The American Taxpayer Relief Act of 2012 enacted a permanent set of estate, gift and generation-skipping transfer (GST) tax provisions with the lifetime exemption set at $5.34M for 2014 (indexed annually for inflation).

Gifting and Life Insurance

Gifting and life insurance are a particularly powerful combination. If life insurance is owned by an ILIT, the trust will generally receive the policy death benefit free of estate and income tax.[3] Clients can make annual exclusion gifts to an ILIT, up to the number of trust beneficiaries who are given "Crummey" rights of withdrawal. If the trustee uses the gift dollars to purchase life insurance, the death benefit to the heirs often can be substantially leveraged as compared to the value of the original gift.

Did You Know...

- If your client uses their full lifetime gift exemption during life, this will reduce their estate tax exemption at death. At a basic level, in 2014 individuals can either gift $5.34M during life or at death without incurring gift or estate taxes (an individual can choose to gift more money than their exemption and annual exclusion, but gift taxes may be assessed.)
- Gifting money to a second generation can result in an additional tax known as the Generation-Skipping Transfer (GST) tax. This is in *addition* to gift and estate taxes (the GST exemption for 2014 is $5.34M).
- Individuals can also loan and/or sell assets to a trust. These type of transactions are generally not subject to gift taxes.
- For those clients that are uncomfortable making irrevocable gifts, special provisions can be drafted into the trust to potentially give access to beneficiaries, including a spouse.

Considerations

- Plan requires evidence of insurability.
- Life insurance may have fees associated with it, such as the cost of insurance.
- Transfers to an ILIT are irrevocable and may only be used for the benefit of trust beneficiaries. There are costs associated with setting up an ILIT.

CASE STUDY

CLIENTS/BACKGROUND: John and Sarah Miller are both 65, Preferred Non Smokers and have two children. Their estate is currently worth $15M, and is growing at an after-tax rate of 2% a year. They have never done any planned gifting in the past, and are interested in looking at the ways that lifetime gifting can reduce their estate tax exposure. Their financial planner recommends that they establish an Irrevocable Life Insurance Trust (ILIT) and fund it with annual exclusion gifts.

ASSUMPTIONS: The table below shows three different possible scenarios for the Millers: no lifetime gifting, gifting to an irrevocable trust and investing the gifts, and gifting to an ILIT and having the trustee purchase life insurance. In this example, the hypothetical growth rate for assets inside their ILIT is 3.5%. If the Millers make annual exclusion gifts of $56,000 every year to an ILIT, the trust will be able to purchase a John Hancock Current Assumption Survivorship Universal Life policy for just under $5M of death benefit.

COMPARISON OF VALUES IN YEAR 25

		DO NOTHING	GIFT TO A TRUST AND INVEST (IT)	GIFT TO A TRUST AND BUY LIFE INSURANCE (ILIT)
Estate Today Prior Taxable Gifts Made		$15,000,000	$15,000,000	$15,000,000
Total Premiums Paid by Year 28				$1,568,000
Cumulative New Gifts by Year 28 New Gifts Taxes Paid by Year 28			$1,568,000	$1,568,000
Total Estate in Year 28		$20,101,656	$17,985,291	$17,985,291
Estate Taxes	–	$5,904,662	$5,125,316	$5,125,316
Credit Shelter Trust	+	$5,895,791	$5,895,791	$5,895,791
Other Assets in Trust in Year 28	+		$2,683,005	$0
Death Benefit in Year 28	+			$4,750,000
Net to Heirs in Year 28	=	**$20,092,785**	**$21,438,771**	**$23,505,766**
Potential Gain Due from Planning			**$1,345,986**	**$3,412,981**

This is a supplemental illustration. Not all benefits and values are guaranteed. The assumptions on which the non-guaranteed elements are based are subject to change by the insurer. Actual results may be more or less favorable.

As the chart indicates, by gifting to an ILIT and purchasing life insurance, the Millers can reduce their expected estate tax liability and significantly increase the amount to their heirs.

In addition to annual exclusion gifts, clients can also gift all or some of their estate tax exemption without it being subject to gift taxes. The case below illustrates the benefits of using lifetime gifts:

CASE STUDY

CLIENTS/BACKGROUND: Anna Seller, 70, Preferred Non Smoker, has an estate worth $20M, growing at 2.0% after tax. The following scenario illustrates no planning, compared to making a $5M gift to the trust which grows at 3.5% after tax.

COMPARISON OF VALUES IN YEAR 20

		DO NOTHING	GIFT TO A TRUST AND INVEST (IT)	GIFT TO A TRUST AND BUY LIFE INSURANCE (ILIT)
Estate Today Prior Taxable Gifts Made		$20,000,000	$20,000,000	$20,000,000
Total Premiums Paid by Year 20				$3,700,000
Cumulative New Gifts by Year 20 New Gifts Taxes Paid by Year 20			$5,000,000	$5,000,000
Total Estate in Year 20		$29,718,948	$22,289,211	$22,289,211
Estate Taxes*	–	$8,203,579	$7,148,484	$7,148,484
Other Assets in Trust in Year 20	+		$9,948,944	$4,534,092
Death Benefit in Year 20	+			$8,000,000
Net to Heirs in Year 20	=	**$21,515,369**	**$25,089,671**	**$27,674,819**
Potential Gain Due from Planning			**$3,502,302**	**$6,087,450**

*A 3% CPI has been applied in this case.

This is a supplemental illustration. Not all benefits and values are guaranteed. The assumptions on which the non-guaranteed elements are based are subject to change by the insurer. Actual results may be more or less favorable.

Summary

Gifting can reduce estate taxes, maximize gifts to loved ones, and help avoid the probate process, as well as potential creditors' claims. However, the real power of lifetime giving becomes apparent when it is combined with purchasing life insurance in an ILIT. Life insurance often multiplies the value of the gift and provides a lasting legacy to future generations. Use JH Solutions to show your clients the power of gifting and life insurance.

For more information, please contact your local John Hancock representative or call the Advanced Markets Group at 888-266-7498, option 3.

1. Trusts should be drafted by an attorney familiar with such matters in order to take into account income and estate tax laws (including the generation-skipping transfer tax). Failure to do so could result in adverse tax treatment of trust proceeds.
2. Gifts to a trust may qualify for the annual exclusion if they are "present interest gifts" and the trust beneficiaries must have "Crummey" rights of withdrawal over the gifts.
3. Life insurance death benefit proceeds are generally excludable from the beneficiary's gross income for income tax purposes. There are a few exceptions such as when a life insurance policy has been transferred for valuable consideration.

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