Top 10 Reasons Why Wealthy Individuals and Families Buy Life Insurance

1 Dynasty Trust

Dynasty trusts are multigenerational irrevocable trusts established by ultra-high net worth families ($25 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 and the Dynasty Trust serves 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 for a client with a net worth in excess of $5.34 million or $10.68 million for married couples.

Life Insurance Solution:

To provide the liquidity to pay these 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 counted as part of their estate for estate tax purposes. Survivorship life insurance is an attractive consideration for such purposes because generally survivorship life insurance has lower relative premiums 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 right to inherit assets erode asset values intended for heirs.

Life Insurance Solution:

Clients often choose to purchase life insurance to help offset the cost of inheritance taxes, since if properly arranged, the policy death benefit is income-tax free death benefit (according to IRC101(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 clients 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 what they want to leave and protect it, too?

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 have moved away from home and may not want to return to continue in the family business. 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 child who moved away.

Life Insurance Solution:

Similar to estate equalization, for clients regardless of net worth, 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.

6 Estate Equalization

Estate equalization may be an issue. For example, one child may live close to home, while another child lives away. In such a situation, the client may give a home 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 to provide a death benefit inheritance to the child or children who moved away and will not inherit the home or parcel of land. The death benefit can provide monetary value equivalent to the home or land, thereby giving all heirs an equal share.

7 Stabilize Wealth for Clients with Concentrated Stock

Clients who have a large disproportionate stock position in one particular company are exposed to company-specific risk and stock price volatility. As the stock market moves up and down so does the price of the stock and often times there are 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 his assets to create wealth for the next generation while helping to diversify the portfolio for his heirs. Life insurance provides: 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 he or she receives them. Those monies are considered Income in Respect of Decedent (IRD). This issue of IRD taxation 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 these IRD taxes upon their heirs. The income-tax free death benefit from the life insurance policy can be used to pay the taxes that are due.

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 children who have special needs, special needs planning typically refers to the necessity of establishing a trust for children with 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 other services (e.g., governmental assistance).

10 Charitable Giving

Some clients want to leave a charitable legacy, but don't want the legacy to diminish 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 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.

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