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Wait-and-See trust strategy for estate planning

A Wait-and-See Estate Planning strategy uses a combination of life insurance and trusts in a way that offers clients flexibility to support changing circumstances throughout their lives. It is a strategy for married couples who want to maintain control of, and access to, life insurance policies that eventually fund their legacy and provide liquidity to pay estate taxes.

There are two approaches your customers can take, depending on their situation. In most situations, your clients will employ a two-policy approach. The two-policy approach covers two main objectives: accumulation for retirement purposes and flexible estate planning.

How the wait-and-see two-policy strategy works

A couple applies for two individual life insurance policies. Each policy is owned by the other spouse.

Spouse 1's estate
Insured: Spouse 2

Owner: **Spouse 1**

Beneficiary: **Spouse 1's credit shelter trust**

Spouse 2's estate
Insured: Spouse 1

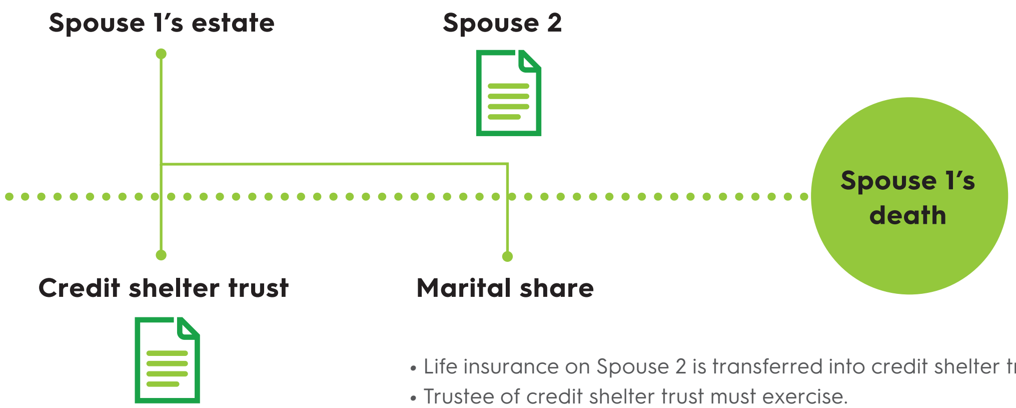
Owner: **Spouse 2**

Beneficiary: **Spouse 2's credit shelter trust**

Estate planning decision points

Spouses may decide to place their policy into an Irrevocable Life Insurance Trust between the ages of 65 and 70, and at that time decide to do wait-and-see estate planning.

When one of the spouses dies,[1] a credit shelter trust is established and the policy insuring the surviving spouse is transferred into it. The trust is now the owner of the policy. Proceeds from the policy insuring the deceased spouse are paid to the surviving spouse.



- Life insurance on Spouse 2 is transferred into credit shelter trust.
- Trustee of credit shelter trust must exercise.

Credit shelter trusts are typically funded by assets with a fair market value that equals up to the Federal Estate Tax Exclusion. The remaining estate funds Spouse 2's Marital Share (the remaining assets in the deceased spouse's estate now belong to the surviving spouse).

An alternative method of funding the credit shelter trust is to transfer the policy on the surviving spouse into the credit shelter trust and allow the surviving spouse to own the couple's assets. To maximize tax benefits, however, it is important that the surviving spouse claim the deceased spouse's Federal Estate Tax Exclusion, otherwise known as the "Deceased Spousal Unused Exemption Amount." It allows a spouse to reap the tax benefits without locking assets into irrevocable trusts.

The value of the policy as it is moved into the credit shelter trust will equal its fair market value on the date of death. This is important for calculating the value of an estate for tax purposes and maximizing the use of the Federal Estate Tax Exclusion.

- The fair market value of an asset is determined at the time of the spouse's death.
  - The fair market value of a life insurance policy on the surviving spouse is not the death benefit, but an amount close to the policy's cash value because the spouse is still alive.
  - Credit shelter trusts are typically funded with assets that appreciate in value. This is because all proceeds in the trust, including any appreciation, pass tax-free to the beneficiaries upon the insured's death.
- The remaining assets in the surviving spouse's estate and the Marital Share can be used as a source of income for ongoing expenses.
- Upon Spouse 2's death, the life insurance pays a death benefit, further funding the credit shelter trust.
  - Estate taxes are assessed on the surviving spouse's estate and the Marital Share.
- The proceeds from the credit shelter trust help pay any estate tax due on Spouse 2's estate and the Marital Share.
- The remaining value passes tax-free to Spouse 2's beneficiaries.

One policy strategy

If there is a clear, mortality-inferior spouse, it might be advisable to use a 2nd-to-die, or survivorship life insurance policy, taking advantage of joint mortality costs in the policy.

With this approach, the mortality inferior spouse applies for and personally owns a second-to-die life insurance policy. The policy owner's credit shelter trust should be named as primary beneficiary of the policy. The benefit of using this approach is the couple can maintain ownership and therefore access to the accumulation in the cash surrender value instead of locking the policy into an irrevocable trust from the start.

Insured: Spouse 1 and Spouse 2

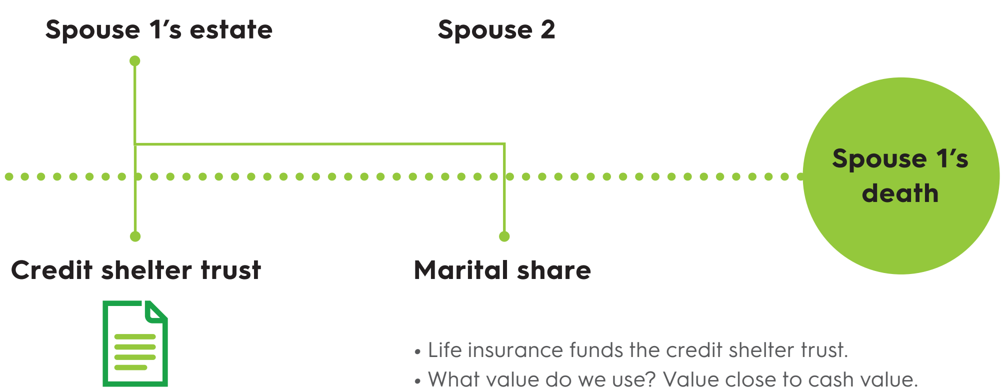
Owner: Spouse 1

Beneficiary: Spouse 1's credit shelter trust

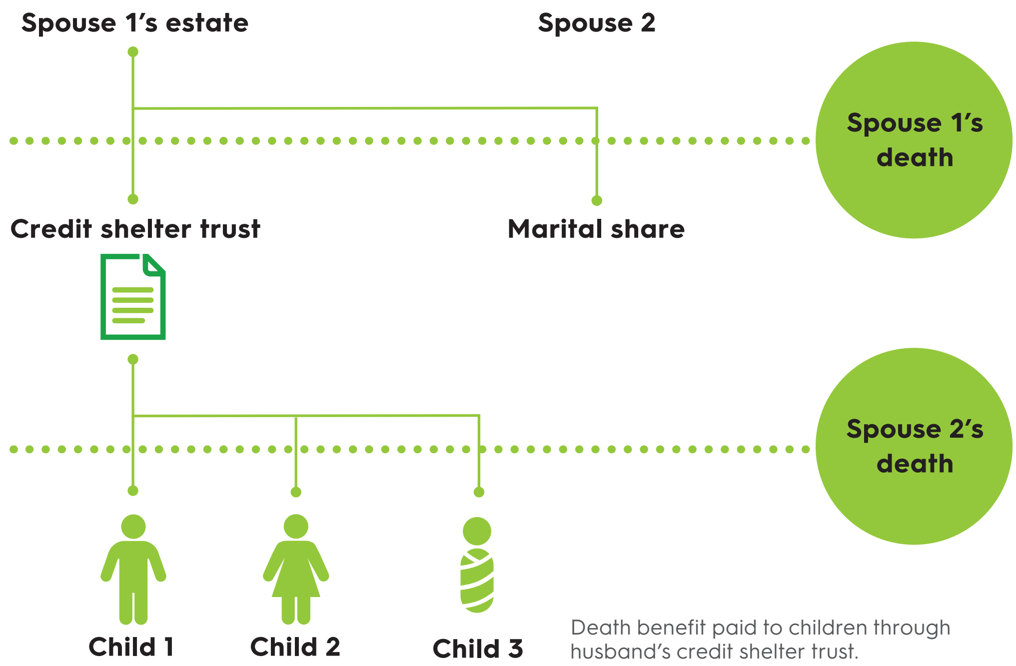
If the policy owner dies first

If the policy owner dies first, a special personal representative or trustee passes the policy to the decedent's credit shelter trust utilizing a portion of the decedent's applicable exclusion. Estate taxes may be payable to the extent the cash value of the policy exceeds the Federal Estate Tax Exclusion then available.

The special personal representative, however, may remove some cash surrender value before transferring it to the credit shelter trust to avoid incurring estate taxes. At the subsequent death of the surviving spouse, the death benefit is received by the trust entirely free from both estate and income taxes.



- Life insurance funds the credit shelter trust.
- What value do we use? Value close to cash value.



If the non-policy owner dies first

If the policy owner's spouse dies first, the policy owner may need to transfer the second-to-die policy to an Irrevocable Life Insurance Trust (ILIT) to avoid estate taxation. This transfer could cause gift taxation if the policy cash value exceeds the Federal Estate Tax Exclusion plus any available annual exclusions. In addition, if the policy owner dies within three years of the transfer to the ILIT, the death proceeds would be included in his estate under the three-year rule. However, the trustee can eliminate this concern by purchasing an optional policy rider that will provide the option to purchase four years of term coverage. This rider could provide the trustee with the option to purchase four years of additional term insurance (up to 122 percent of original face amount) without proving insurability. This amount can be used to offset the additional estate taxes generated by the inclusion of the death benefit due to the application of the three-year rule. The option to buy the term insurance is activated by the death of the policy owner's spouse.

Wait-and-see strategy

Benefits

Prior to the first death:

- Access to the life insurance policy's cash value for supplemental retirement income or emergencies.
- Flexibility to make changes throughout life of the insured. Because spouses own the policies, they can increase or decrease the death benefit and premiums.
- Control over the funding of the policies. Spouses can fund their policies today without giving up control of their assets – which can happen with other estate planning approaches.
- The opportunity to minimize the impact of federal estate taxes.

Considerations

- Can only be used with married couples.
- Specific drafting in spouses' estate planning documents needs to be completed to implement the strategy.
- Possible inclusion of death benefit proceeds in their estate.
- Fees and expenses associated with the purchase of life insurance. Policy must be maintained to ensure the success of the strategy.
- If spouses live in a community property state, they should sever respective community property interests in the life insurance policy owned by the other spouse. Have them consult local legal counsel on this issue.
- At the first death, the surviving spouse may need to work with a probate court to set up trusts, if the couple is not using a Revocable Trust.

Learn more

To learn how a Wait-and-See Trust strategy can help build a secure financial future for your clients and their families, contact your Life Sales Support Team today:

1-888-413-7860, option 1

1. If owner/insured are different, the death benefit will be paid upon death of the insured.

Please keep in mind that the primary reason to purchase a life insurance product is the death benefit.

Life insurance products contain charges, such as Cost of Insurance Charge, Cash Extra Charge, and Additional Agreements Charge (which we refer to as mortality charges), and Premium Charge, Monthly Policy Charge, Policy Issue Charge, Transaction Charge, Index Segment Charge, and Surrender Charge (which we refer to as expense charges). These charges may increase over time, and the policies may contain restrictions, such as surrender periods.

Additional agreements may be available. Agreements may be subject to additional costs and restrictions. Agreements may not be available in all states or may exist under a different name in various states and may not be available in combination with other agreements.

Policy loans and withdrawals may create an adverse tax result in the event of lapse or policy surrender, and will reduce both the surrender value and death benefit. Withdrawals may be subject to taxation within the first fifteen years of the contract. You should consult your tax advisor when considering taking a policy loan or withdrawal.

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