
# The Plan B Solution to Estate Tax Increases

Good planners know that their high net worth clients should take full advantage of their $11,700,000 lifetime exemption from estate taxes NOW. And if their clients are married, that means transferring $23,400,000 to somewhere that is outside their otherwise taxable estate. The estate tax exemption is about to go down, if not in the latest tax proposals, then in 2025, when the generous exemptions return to half the $23,400,000.

We could bring in additional aspects of this strategy, but that's not the point of this discussion. It seems that almost all of the articles being produced address this strategy and the various ways to capture the vanishing estate tax exemptions. What many planners miss is what happens when their clients don't have a positive reaction to the suggestion that they make this large transfer, even if they can remain in control through various designs.

*Is there something else your clients should consider to address the resulting increase in their estate taxes? The easy answer is, "yes".*

Before we go to Plan B, let's take a moment to think about why a client would not take full advantage of a fantastic tax opportunity that is about to vanish. In our experience, the first issue is one of control. Now control is not necessarily a good or a bad thing, so we are not being judgmental. We are simply being realistic. Asking a client to move valuable assets currently under his or her control to a trust or entity over which the control is not the same can be asking too much. Clients tend to enjoy the ability to make decisions about their assets without restrictions. They may also depend on the income generated by the assets.

Then there are very important family issues in play. In the case of married clients, they may not be especially forthcoming concerning the challenges their marriage may face. When directly working with clients years ago, I had a client balk at an estate plan that appeared to be perfect. I thought I had to be the worst communicator in the world and wondered where I went wrong. Then, a couple of weeks later, it was announced that the clients had initiated divorce proceedings. Everything then made sense. While you may have clients who are not on the verge of a divorce, you need to be attentive to nuances that can make the perfect plan a not-so-perfect plan. Even the slightest relational conflict can stop a client from moving assets in other directions out of his or her control.

Issues with children can also be a strong reason assets don't get transferred before death. All kinds of concerns can arise, including lack of wisdom with money, unwanted exposure to the reach of a spouse, impact of large sums of money on a child's lifetime motivations, or even the desire to avoid treating one or more children differently when equalization is the ultimate goal.

Beyond the hidden family issues, clients may also have a hard time with attorney fees and the costs of asset valuations, often a critical part of these transactions. Related to the costs of the appraisals is the risk that large transactions will attract the interest of the IRS, possible audits, and the risk of back taxes and penalties being charged on valuations that are challenged. Here's one related prediction: even if a client doesn't like paying attorney fees, he or she might not have the opportunity to transfer assets in the last quarter anyway. We expect that attorneys may be overwhelmed with the rush of clients seeking an effective response to whatever tax reform is ultimately passed. We have even been told that some attorneys are warning clients to move quickly before other clients make decisions that take up the attorneys' available time.

For these reasons and many more you may have heard, we expect that a significant percentage of the people who should take advantage of asset transfers will not do anything. And don't forget all of the families that have a net worth that was free of estate taxes but now is caught in the lower tax threshold.

*Fortunately, for many of these families, there is a Plan B that is simple, measurable, and flexible: fund the new estate taxes with discounted dollars.*

That's where life insurance can solve their new problem.

The logic is quite simple. Clients facing new and additional future estate taxes should consider pre-funding this liability now. If the higher estate subject to taxes is approximately $11,700,000, then the additional taxes about to be charged will be around $4,680,000 assuming a 40% estate tax rate. Allowing for loss of valuation discounts and some asset growth that could have been diverted off the estate tax return, let's round this up to $5,000,000 (that growth factor could be quite a lot larger in the more distant future). Thus, the basic cost of keeping asset ownership where it is should be around $5,000,000 for starters. It's that simple. The same logic that drives high net worth families to fund estate taxes with insurance is applicable here. Whatever estate taxes families thought they needed to fund will now be $5,000,000 higher. Also, as mentioned above, a large number of new families will be exposed to estate taxes, and they will need to address how to pay those taxes as well.

For families who want to consider the discounted pre-funding option, we now need to assess insurability and then look at pricing based on their age. You can fund this new liability using any form of life insurance, including fixed universal, whole life, indexed universal, guaranteed no-lapse, or variable. We would not recommend term, since carriers will not continue such coverage beyond a date short of life expectancy, when the death benefit is most likely to be needed. Our calculation of the need was based on a married couple, so let's look at the cost of $5,000,000 of survivorship coverage for some sample ages where the husband and wife are the same age. The premiums are annual lifetime premiums, but many clients will pay a higher annual amount to fund the coverage over a shorter period of time, such as 10 years. In addition, I have shown the total premiums paid to age 90 and internal rate of return on the death benefit at age 90, something a little farther out than typical life expectancy:

We assumed that the husband had minor health issues, resulting in a Standard premium assessment, while the wife was issued at Preferred. Of course, the actual health rating, the product we use, the carrier we select, and the premium pattern will vary with each individual. You, as the key advisor, will play a key role in narrowing down which products are best for the client. It is interesting to note that the total amount of premiums paid at all ages shown is far less than 50% of the $5,000,000 death benefit. Also, the internal rates of return are even more attractive when you consider that these rates are free of income taxes and free of estate taxes when the insurance is properly kept outside of the taxable estate.

So, the Plan B life insurance option can be a great solution for many of your clients who will be shy about making significant and rushed gifts prior to the end of 2021. The new $5,000,000 estate tax increase is quite manageable, and many wealthy clients need to know they are about to have this new tax liability in their estate. By addressing this now with your clients, you will have done them a great service. You will have covered the new liability, leaving your clients with maximum flexibility to manage their assets in the future. Come to think about it, maybe we should redesignate Plan B to Plan A. It will certainly suit more clients than you think!

## $5,000,000 of 2nd to Die Cash Value Life Insurance

| Ages | Annual Premiums | Total Paid to Age 90 | IRR at Age 90 |
|---|---|---|---|
| 55/55 | $40,766 | $1,426,810 | 6.30% |
| 60/60 | $52,703 | $1,581,090 | 6.65% |
| 65/65 | $73,053 | $1,826,325 | 7.07% |
| 70/70 | $98,524 | $1,970,480 | 8.22% |
| 75/75 | $142,135 | $2,132,025 | 10.07% |

*"The Plan B life insurance option can be a great solution for many of your clients who will be shy about making significant and rushed gifts prior to the end of 2021."*

Finally, we need to warn advisors that some life insurance companies may be overwhelmed with year end business in 2021, requiring the careful, complete, and timely presentation of a well-constructed underwriting package. The earlier you can let AdvisorServe know that you have a potential situation, the more likely we can find the right coverage for your clients at the best price. We are ready to help, even if it is only in assessing pricing for your clients.

Presenting both Plan A and Plan B show you are on top of the situation. Plan C – do nothing – helps no one.


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