Procrastination & Taxes

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The topic of estate tax continues to be a popular chip in the political poker game. As a result, laws that impact legacy planning change – often, with the most recent change coming through the Tax Cuts and Jobs Act. There are two concepts providing excitement for the wealthy which seem to appear every time there is an election:

1. The exemption will be so high that only the mega-wealthy will be impacted
2. The estate tax will be eliminated altogether

However, each time the dust settles, there are still important reasons for estate liquidity. That said, with the hope that the estate tax might not impact their estate (no matter how realistic), there are wealthy people all over who are procrastinating parts of their estate planning, including the purchase of insurance for liquidity. Specifically, the recent increase of the estate tax exemption to $11.2 million may lull affluent clients into a false sense of security, not realizing that the increased exemption is only temporary. With the scheduled reversion of the exemption back to $5.6 million (indexed for inflation) in 2026, those who fail to plan could miss out on opportunities to minimize their estates' exposure to taxation.

Instead of procrastinating important insurance planning, perhaps it makes sense to explore reasons why now is the appropriate time to plan:

1. There is only one year in the past century, 2010, when there was no estate tax.
2. The estate tax exemption is already scheduled to be reduced in 8 years, and it could be reduced even sooner if Democrats continue the trend of what occurred in 2017.
3. A change of health could make life insurance unavailable or much more costly in the future.
4. As people age, life insurance generally costs more. The purchase of life insurance earlier locks in lower premium amounts for life with guaranteed products.
5. Assuming a guaranteed death benefit plan is purchased by an irrevocable trust and the insured life lives to life expectancy, the internal rate of return is likely to approach 6% and the death benefit will be delivered income tax free to the trust, already outside of the grantor's estate. Considering that the premium and death benefit are guaranteed for life, it represents favorable portfolio diversification, even if the estate tax doesn't ultimately impact the estate.
6. It's guaranteed! This point can't be stressed enough. Regardless of future interest rates, market performance, etc. carriers with guaranteed death benefit plans offer the unique opportunity to provide a fully guaranteed instrument with premiums and benefits that won't change.
7. The trust does more than just protect the benefit from being included in the estate tax calculation; it builds a moat around the money. The funds are protected for the beneficiaries from creditors, divorcing spouses, themselves, etc.
8. The grantor can create a variety of provisions in the trust that will determine how and when beneficiaries access trust assets.

Q. What's the worst case scenario that could happen?
A. Life insurance is acquired and there is no estate tax/liquidity need.

The result is that a significant amount of money will be available to loved ones at the time the grantor passes. The money will be in a trust, will avoid probate, will be paid almost immediately, will be protected from creditors of both the grantor and the beneficiaries, will be protected from divorcing spouses, from beneficiaries who are not capable of handling money in an appropriate way, etc. All things considered a great outcome regardless of the tax status of the estate.

A Helpful Tip
If estate tax repeal was going to happen, 2017 provided the best opportunity to do so. Instead, we ended up with a temporarily increased estate tax exemption. Ask your clients if they can foresee a future where the government will allow citizens to pass huge fortunes to the next generation without taking their pound of flesh. Most would agree, it doesn't seem likely and are willing to start the planning process.

In light of estate tax laws that have been changing for more than 100 years, predicting how the tax will look decades from now is impossible. Making reasonable assumptions and taking steps that could be critical to the success of legacy planning is prudent, appropriate and essential.