It’s Time to Get Reacquainted with Survivorship Life Insurance

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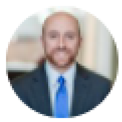

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For wealth managers who work with ultra-affluent clients, survivorship life insurance has been a staple in estate tax planning for many decades. However, with the exemption rising to $23M+ for a married couple, those who have more modest wealth have largely ignored the federal estate tax and gifting opportunities alike. In some cases, when the lifetime exemption increased in 2016, existing life insurance policies were surrendered, reduced or (worst case scenario) the funding stopped, leaving the policies heavily underfunded. With President Biden’s 4.1 trillion dollar infrastructure bill facing a reconciliation vote in mid-to-late September, high income earners and the ultra wealthy are clearly in the crosshairs of tax hikes, putting the need for estate liquidity back on the forefront of transfer tax planning. As such, here is a quick summary of where the survivorship life insurance market is today and how advisors can best support clients with their liquidity needs:

Why there is a need for liquidity:

As the law stands today, on January 1, 2026, the lifetime exemption is scheduled to decrease to $5M per person ($10M for a married couple) indexed for inflation, significantly increasing the number of households who, once again, must plan if they wish to minimize the impact of taxes on their estates. Approximately 40% of the gross estate that exceeds the exemption amount could be lost to the federal estate tax. Generally, the federal estate tax is due nine months after the second passing (assuming a married couple). Given that many affluent families have their net worth tied up in business and/or real estate assets that are relatively illiquid (and that they don’t want to liquidate), there is a very clear need to provide usable dollars (liquidity) for these families.

Why life insurance is an effective tool in providing liquidity for an estate:

Simply put, life insurance is an ideal asset to hold outside of one’s estate that provides for substantial liquidity needs for pennies on the dollar. Generally speaking, at life expectancy, a typical permanent life insurance policy will provide an internal rate of return on the death benefit in the 5-6% range. Because life insurance generally pays income-tax-free, the pre-tax equivalent yield is generally 7-9%. Additionally, when owned by an Irrevocable Life Insurance Trust (ILIT), the death benefit is generally not includable in the taxable estate and therefore, not subject to the federal estate tax.

Why survivorship life insurance is typically used in lieu of an individual policy:

Survivorship life insurance pays upon the second passing of the insured lives, which is also the time of the taxable event due to the unlimited marital deduction. Because the insurance company generally collects premiums longer and pays a death benefit later, the premium is less. In other words, clients receive greater leverage on their premium dollars. Even when one spouse is relatively unhealthy (or maybe not even insurable on an individual policy), insuring two lives is almost always more competitively priced than a single life alone.

Why survivorship life insurance is commonly owned by an Irrevocable Life Insurance Trust (ILIT):

If the policy is owned by the insured(s) personally, it is includable in the gross estate tax calculation, thus exacerbating the tax obligation. When owned by an ILIT, it is generally not includible in the grantor's taxable estate. The grantor makes gifts to the trust and the trustee then pays the insurance company the premium. At death, there is substantial liquidity that can be made available to the estate to pay taxes while ILIT assets also avoid probate.

Today's survivorship life insurance market:

Due to the low interest rate environment, many of the most consumer-friendly products in today's market are variable universal life policies with lifetime no-lapse protection. These plans are particularly attractive in 1035 exchange and short-pay scenarios. Because these plans are variable, they are less general account sensitive for the insurance carrier, which translates into more favorable pricing. Traditional universal life with lifetime no-lapse protection are still available and, in certain demographics and level-pay situations, are still very competitive. Survivorship whole life is also readily available and can provide robust guarantees, but typically comes with a substantially higher price tag.

Beware of products with shortened guarantees or gimmicky features – the devil is in the details. The purpose of life insurance is to transfer risk. Policies that do not provide sufficient lifetime guarantees place a significant amount of risk back on to the trustee, can be difficult to manage and can require substantial future premium contributions to meet expectations.

Getting to the attorney:

For clients who have taken the “wait and see” approach, be prepared for a significant delay in getting into the estate planning attorney’s office. Reports from across the country suggest these offices are flooded and late comers will be waiting in a rather lengthy line.

The long-rumored tax changes are about to become a reality. As such, it is important for advisors to get reacquainted with survivorship life insurance, along with other estate planning tools that can limit transfer tax exposure.