Michael Lagos
(866) 444-4964
mlagos@lagosadvisors.com

Robert Langsam
(800) 825-9990
rlangsam@lagosadvisors.com

LAGOS WEALTH ADVISORS
BUILDING, PROTECTING AND PERPETUATING FAMILY WEALTH

Enhancing the Lifetime Gift

In 2016 we saw a flurry of clients taking advantage of their lifetime gift tax exemption in fear that the tax exemption would be substantially reduced. While we have seen an extension of the increased gift tax exemption, it did not matter for many of these clients who rushed to complete their gift in 2012, since they probably should have been taking advantage of making lifetime gifts as part of their estate planning strategy.

By making a gift up to the new lifetime gift limits, a high net worth individual transfers the asset's value out of his or her taxable estate and transfers all potential appreciation in the asset at no additional transfer cost.

However, for many of these clients, even after taking advantage of the gift tax exemption, they are still left with a highly taxable estate and require additional tax planning. Many may be reluctant to give up control over their remaining assets, as a result of the current income they may produce, or for a variety of other concerns. Regardless of the reasons, these clients still face a significant estate tax liability.

It is important to evaluate the assets that were gifted and the current income they may produce within the Trust. More likely than not, distributions of trust corpus are probably anticipated to begin many years in the future. Income distributions may or may not be planned, but with the increased trust income taxation rates alternative strategies may be warranted to minimize or avoid trust income taxation.

As a result, Trust management of the gifted asset becomes increasingly significant. There may be opportunities in considering alternative strategies that are capable of addressing the Client's remaining estate tax liability or liquidity needs.

To further maximize wealth transfer, the increased lifetime gift can be used to seed the Irrevocable Trust with capital (retained capital) to purchase individual or joint life insurance with a significantly higher death benefit amount.

The result would substantially reduce the effective cost of the remaining estate tax liability, as well as provide substantial liquidity for the redistribution of estate assets.

This purchase can be further leveraged by incorporating a traditional premium financing strategy that will discount the cost of acquiring the life insurance policy. By accessing the retained capital within the Trust, or its investment return, the future value of the Retained Capital combined with the policy death benefit can represent a substantially greater estate tax-free value to the heirs.

Additionally, the interest cost of the financing strategy will reduce the net trust income subject to taxation, while still allowing for current trust distributions.

An Example to Enhance the Wealth Transfer: A couple ages 63 (husband) and wife age 60 make a gift of $10 million. The gifted asset, or invested cash yields 4%. To enhance the estate transfer the Trust takes a loan to acquire a life insurance policy with an initial Death Benefit of $37 million net of the loan.

Trust income exceeds the interest cost of the borrowed funds, and the excess return grows within the Trust or remains available for current trust distributions. The loan is paid off in year 16 from the life insurance policy cash values, and the policy remains in force until death.

The Trust in year 16 if the life insurance was not acquired, and the 4% return was entirely reinvested (no trust income distributions), would have grown to $18.4 million.

The life insurance cash value and Trust asset in year 16 amounts to $23.5 million *after the loan is paid off*. This is greater than the trust asset would have grown to if all earnings were reinvested.

However, the **Death Benefit combined with the Trust asset amounts to $50.5 million** – *additional wealth of $31.7 million, nearly double the amount has been created and no gift taxes were paid*.