John Hancock INSURANCE

Lifetime Gifting

CLIENT SNAPSHOT

ESTATE PLANNING

A simple way to transfer wealth and reduce the size of your taxable estate

As you plan for what type of legacy you'd like to leave, passing on your hard-earned assets to the government in the form of estate or inheritance taxes probably doesn't top your list of goals. One of the best ways to protect your family and minimize your exposure to transfer taxes is to start planning today.

In today's tax environment, with the lifetime exemption from gift and estate tax at an all-time high, implementing a gifting strategy can help protect against future estate tax exposure, even if you do not currently have a taxable estate. Gifting also allows you to meet other planning goals such as avoiding probate, increasing creditor protection, and giving you greater control and flexibility over how your assets will be distributed. A lifetime gifting strategy, when combined with life insurance, may also increase the total amount passed on to your heirs.

Understanding U.S. transfer taxes

The United States federal government imposes tax on the transfer of wealth above certain amounts. There are **three** distinct types of "transfer taxes" that may apply:

1. **Estate tax:** tax on the transfer of property at death.
2. **Gift tax:** tax on the transfer of property during life. The gift tax serves as a "backstop" to the estate tax, preventing wealthy individuals from transferring away assets during life to circumvent the estate tax.
3. **Generation-skipping transfer (GST) tax**: tax on the transfer of property (during life or at death) to individuals who are more than one generation removed from the donor – commonly referred to as "skip persons" (e.g., a grandchild).

STATE TAXES

In addition to federal taxes, a number of states impose a state level estate tax or inheritance tax. Check with your advisor to determine if you may be subject to one of these taxes based on where you live or own property.

Transfer taxes are only due when total gifts made during life or at death exceed certain limits.[1]

- **Lifetime Exemption:** You can give away a certain amount of money or property during life or at death without incurring any gift or estate tax. This amount is commonly referred to as the "lifetime exemption" and is currently $11.18M for individuals and $22.36M for married couples (as of 2018). Any transfers made in excess of this exemption are taxable at a 40% rate.

TIME'S UP

Under current law, the **Lifetime and GST Exemptions will be reduced to $5M** (indexed for inflation) in 2026.

- **GST Tax Exemption:** The GST Tax exemption, which applies to gifts and bequests to grandchildren and other "skip persons," is also $11.18M per individual. Transfers that exceed this exemption are taxable at a 40% rate.
- **Annual Exclusion Gifts:** In addition to your lifetime exemption, you can also gift up to $15,000 a year (for 2018) to as many individuals as you would like without incurring a gift tax. Spouses have the ability to combine their annual exclusions amounts to give a total of $30,000 per person per year.

Maximizing your legacy with life insurance

Implementing a gifting plan to fully utilize your available exemptions can help to significantly minimize or eliminate your exposure to estate taxes. One very effective strategy is to make gifts to an irrevocable life insurance trust (ILIT) using annual exclusion gifts and/or some of your lifetime exemption and having the ILIT trustee use the gifted funds to purchase life insurance.

Step 1: Your attorney drafts an irrevocable life insurance trust (ILIT).[2]

Step 2: You fund the trust each year by making annual exclusion gifts of $15,000 for each beneficiary of the trust. Depending on how many trust beneficiaries there are, the total amount you can gift on an annual basis without tapping into your lifetime exemption may be significant. For example, if you have six identified trust beneficiaries, you can gift $90,000 ($15,000 x 6 individuals). You may also decide to use your lifetime exemption to gift larger amounts to the trust.

Step 3: The ILIT trustee purchases a life insurance policy on your life. The ILIT is the owner and the beneficiary of the policy. The policy's annual premiums will be paid each year with the gifted funds.

Step 4: At your death, the ILIT receives the death benefit free from estate taxes. Any other assets in the trust, and any appreciation, are also free from estate taxes. By funding the trust with insurance, you not only remove the gifted assets from your estate, but the policy's death benefit creates an income-tax free pool of money, increasing the overall benefit you pass on.

How life insurance can help

INCOME TAX-FREE DEATH BENEFIT

Death benefit is received income-tax free and can be used to help pay estate taxes (if any) and/or secure a legacy for your beneficiaries

ACCESS TO TAX-FREE INCOME

Any cash value that accumulates inside a permanent life insurance policy can be accessed tax-free and distributed to beneficiaries

COMPETITIVE RATE OF RETURN

The death benefit on the life insurance generally provides a higher rate of return as compared to other investment options through life expectancy

Benefits of trust planning

If estate taxes are a concern, gifting to an ILIT is important because the ILIT structure, when drafted and administered properly, keeps the life insurance death benefit and any other assets free from estate taxes. While you may also consider gifting directly to children or other family members to own the policy, it is often more advisable to gift to an ILIT because of the added protections and flexibility the trust structure offers.

ENHANCED INHERITANCE PROTECTION

- **Greater control** over timing of distributions (e.g. at ages 35/40/45, discretionary income/principal only)
- **Increased flexibility** over distributions (e.g. distributions may be limited to income or for a specific purpose)
- **Ability to preserve funds** for multiple generations
- **Assets may be professionally managed**

FLEXIBILITY AND ACCESS

- **Spousal lifetime access provisions** can provide your spouse with access to funds inside of the trust
- **A multigenerational trust** allows trust assets to pass to grandchildren and future generations without paying GST taxes

EASY FUNDING

- **Ability to use annual exclusion gifts** ($15k per beneficiary in 2018)
- **Increased lifetime exemptions** ($11.18M in 2018) makes it easy to fund larger premium gifts without incurring tax

INCREASED CREDITOR PROTECTION

- **Protection of trust assets** from future creditors who may try to go after you or your estate
- **Protection from beneficiaries' creditors**, such as ex-spouses, other third-party creditors, or in a bankruptcy situation
- **Spendthrift language can protect** a beneficiary from reckless spending and preserve trust assets

Gifting can reduce estate taxes, maximize gifts to loved ones, and help avoid the probate process, as well as protect against potential creditors' claims. However, the real power of lifetime giving becomes apparent when it is combined with purchasing life insurance in an ILIT. Life insurance often multiplies the value of the gift and provides a lasting legacy to future generations.

Contact your financial advisor to see how the power of gifting and life insurance can work for you.

1. Note, these numbers are indexed for inflation annually.

2. Trusts should be drafted by an attorney familiar with such matters in order to take into account income and estate tax laws (including the generation-skipping transfer tax). Failure to do so could result in adverse tax treatment of trust proceeds.

Life insurance death benefit proceeds are generally excludable from the beneficiary's gross income for income tax purposes. There are few exceptions such as when a life insurance policy has been transferred for valuable consideration.

The IRR on death benefit is equivalent to an interest rate at which an amount equal to the illustrated premiums could have been invested outside the policy to arrive at the net death benefit of the policy.

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