For a Limited Time Only: Estate Tax Law Yields a Wealth of Strategies for HNW Clients

A beehive of activity is emerging around the new estate tax environment, and some of that activity includes life insurance.

Insurance and legal experts are rolling out guides, letters to clients, seminars and webinars that identify certain opportunities created by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010.

The law created a $5 million per person federal estate tax exemption ($10 million for couples), but only for years 2011 and 2012. In addition, it set the gift tax exemptions at the same levels, and it put tax rates for estates and gifts that ring in over the exemption limits at 35 percent. Unless Congress changes the law again, the exemption levels for estate and gift taxes will each drop to $1 million per person ($2 million per couple), and the tax rates will jump to 55 percent in 2013.

A Window of Opportunity?

Some experts have taken to calling the two-year period a window (as in "a window of opportunity") that creates certain tax efficiencies for clients.

They are letting clients know that the window will close at the end of 2012.

Some clients whose net worth does not reach the new exemption limits may want to cancel their life insurance or delay buying new insurance because they think their estates are no longer subject to estate taxes, says Randall A. Denha, founder and principal of Denha & Associates PLLC, Birmingham, Mich.

But he says he is telling them that they still need life insurance. Besides, the exemption levels are set to go down later on, he says, so they may need to deal with estate taxes in a couple of years.

John O'Grady, partner, O'Grady Law Group, San Francisco, Calif., agrees. People also need life insurance for buy-sell agreements, estate equalization and charitable giving, in addition to income protection for the family, he says.

Because the current tax law is temporary, many professionals are suggesting that clients establish flexible estate plans. In some practices, this is spurring document reviews, language updates, and sometimes new trust and life insurance funding arrangements.

Denha has been suggesting that couples with less than $10 million in net worth consider setting up a disclaimer trust to ensure the couple will have more flexibility than with traditional A-B trust structures. This will enable a surviving spouse to disclaim all or part of the inheritance from the deceased spouse, he says. That's useful if the estate tax exemptions were to drop after the two-year period, as currently scheduled, thus opening up an estate tax exposure.

Denha is also suggesting that couples consider buying life insurance now, while they are younger and can qualify. If it turns out that they won't need it later on, they can reduce it or consider 1035 exchanges, he says.

James Lange, CPA and attorney, principal for Lange Financial Group, Pittsburgh, Pa., is also in favor of using disclaimers in estate plans for people with less than $5 million. This allows for more flexibility than traditional A-B trust arrangements where inheritances are "carved in stone," he says.

Under his "cascading beneficiary" plan, a surviving spouse is first beneficiary via a will. The spouse then keeps or disclaims as much of the inheritance as desired. The disclaimed amount goes into other trusts for the benefit of children and grandchildren. The details are more involved, but Lange says the bottom line is that the spouse has access to all marital assets, not just some, if desired.

That access enables the spouse's ability to meet financial commitments, including those for life insurance, he says.

Focus on Gifting

When client net worth is above the $5 million/$10 million exemption levels, experts say the key opportunities involve gifting.

"For advanced life professionals, the new two-year period is a fantastic opportunity for using the law's enhanced unified credits to make large gifts," contends Adam Sherman, CEO of Firstrust Financial Resources, a wealth management firm in Philadelphia, Pa. The funding source is life insurance, he says.

This year, his firm has been talking with people who have already given away $1 million. But now that the exemptions are at $5 million per person, "we are pointing out that they can give $4 million more per person."

Big gifting arrangements don't occur overnight, experts say. Still, Sherman is already seeing momentum building. "We hope to effect transactions by 2012, before the two-year period ends," he says.

O'Grady predicts that the two-year period will probably end up ushering in the largest transfer of wealth in the nation's history through use of life insurance.

Why? Because the $5 million/$10 million exemptions will enable people to leverage gifting and life insurance to transfer wealth without estate taxes, generation-skipping taxes and gift taxes, O'Grady says.

Example: A couple decides to use up the $10 million exemption by putting (gifting) $10 million into a trust for the