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RECONSIDERING THE VANILLA INSURANCE TRUST
By Randy Spiro

Advanced estate planning strategies involve gifting programs. Certain strategies include grantor retained annuity trusts or unitrusts and qualified personal residence trusts involve retaining rights in a property for a number of years after which the ownership shifts to someone else, such as the donor's children. Certain strategies such as family limited partnerships involve slicing up ownership between general partnership interests and limited partnership interests and giving away some of these newly created interests.

The above strategies all require a sophisticated donor who is unlikely to get buyer's remorse down the line. A simpler advanced estate planning strategy involves an insurance trust. This trust is irrevocable and the donor's children typically are the beneficiaries. The donor retains no rights in the trust and every dollar transferred to the trust is a gift to the trust beneficiaries.

Insurance trusts typically give each beneficiary the right to withdraw Thirteen Thousand Dollars per year where there is a single donor or Twenty Six Thousand Dollars per year where there is a husband and wife donor (or the amount of the annual contribution divided by the number of children, if this yields a lesser number).

Gifts to the trust in excess of the annual free amounts are charged against each donor's lifetime one million dollar free gifting and where there are excess gifts, a gift tax return (form 709) needs to be filed. Gifts charged against the one million dollar lifetime gifting are also charged against the Three Million Five Hundred Thousand Dollar amount that can be gifted free of estate tax at the donor's death.

The Trustee of an irrevocable trust can use the gifted funds to purchase a life insurance policy on the life of the donor or in the case of a husband and wife a policy on both their lives that does not pay off until both of them die. The purpose of such a trust would be to provide liquidity for the payment of estate taxes. If the insured retains no rights in the irrevocable trust, the policy would not be included in the insured's estate for estate tax purposes, even if the donor died within three (3) years of the trustee buying the policy.

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Lets say the advisors estimate $5,000,000 in estate taxes will be due on the death of the surviving spouse in a husband and wife situation. Assume for sake of argument that $2,000,000 in insurance premiums can buy a paid up policy and that these premiums can be paid $100,000 per year over twenty years. Even if the husband and wife have only two children between them they can make $52,000 in annual free gifts and thus each donor would be only making $24,000 of gifts that would be charged against each of their $1,000,000 lifetime free gifting amounts.

This couple under 2009 laws (which are subject to change) can give away $7,000,000 free of estate tax ($3,500,000 each with an A/B or QTIP Trust). If estate taxes stay in the range of fifty percent (50%) on the excess then an estate in the $17,000,000 range would yield an estate tax in the $5,000,000 range.

Although $100,000 seems more than most couples could afford to give their children each year, a couple with an estate that is expected to rise to $17,000,000 by the time both of them have dies is likely to be able to afford such a level of annul gifting. If such a level of gifting makes them uncomfortable but other advanced strategies seem more interesting to them because they do not involve cash gifts, this author believes that many such donors do not appreciate the seriousness, irrevocability and finality of the non-cash advanced gifting techniques.