Advanced Sales

Estate planning with VUL: "Bet to Live, Bet to Die"[1]

Life insurance has been a helpful tool in estate planning for many years, especially in terms of funding both federal and state estate taxes. Variable universal life (VUL) combines lifelong insurance protection with flexible premiums and cash value you can access while alive. Irrevocable trusts[2] own the vast majority of life insurance policies for estate tax funding. Many trustees find themselves in a dilemma when confronted with a policy that is not guaranteed and is underperforming. This problem manifests itself with discovery that the policy will not last until life expectancy, much less beyond. Preventing this serious issue is an important goal.

Using life insurance for estate and income tax planning is not new. Eliminating risk relative to the delivery of tax-free funds when those funds are needed is available through carefully designed products. Life insurance offers the opportunity to transfer the risk of delivery of cash when needed from the estate owner to an insurance company.

Estate tax planning with VUL

Federal and state estate taxes can be burdensome. As of January 2024, those assets subject to estate tax face a 40% federal rate.[3] Changes to the federal estate tax system are being discussed, but this is not new. Many estate owners use life insurance as a discounting tool through ownership of the policy by an irrevocable trust. Some VUL products offer guaranteed premiums with a guaranteed death benefit delivered at the exact time needed. Conversely, investing requires time and growth to reach a large future value. Gifting appreciating assets is a "bet to live" strategy. Alternatively, VUL is a "bet to die" strategy. The two concepts work in harmony.

For example, a 65-year-old male and his 65-year-old wife need $5,000,000 of liquidity at the death of the survivor for estate tax funding. He can make a lump-sum gift to his trust for the purchase of a life insurance policy that offers guaranteed coverage. This gift provides immediate leverage in the form of the ultimate benefit that is guaranteed whenever the second insured dies. A variable universal life policy offers a guaranteed death benefit, which may allow the trustee to allocate the cash value of the policy more aggressively without having the concern of lapse due to performance. This performance feature has the potential to eventually increase the amount of the death benefit within the policy, which in turn would increase the leverage that the gift originally provided. Of course, positive performance of the policy is not guaranteed. Additionally, there are risks associated with a VUL, including possible loss of principal. If you do not pay your policy premiums, the policy could lapse.

Perhaps the couple is not positioned to gift such a large sum, nor do they have a desire to use part of the applicable exemption. Funding annually for life is the opposite end of the spectrum to a single premium. They could instead choose to make annual gifts for life and guarantee the same death benefit. Assuming the couple has three children, they could use their annual exclusion gifts of $18,000 per person[3] totaling $108,000, which represents only a fraction of the death benefit provided. If one of them remains alive at age 95, the couple will have paid cumulative premiums that still equal less than the amount of the death benefit. This is another way to view the discounting effect of life insurance. The annual premium approach has the same guaranteed premium feature and

Speak with your financial professional today to see if this estate planning strategy may benefit you and the legacy you're building.

Not a deposit
Not FDIC-insured
Not insured by any federal government agency
Not guaranteed by any bank or savings association
May go down in value

LincolnFinancial.com

Lincoln Financial Group is the marketing name for Lincoln National Corporation and its affiliates.

Affiliates are separately responsible for their own financial and contractual obligations.

LCN-6126463-112923
POD ADA 1/24 **Z03**
Order code: LIF-VUL-ARC001

Lincoln Financial Group®

guaranteed death benefit as the single premium; therefore, the trustee would take the same position relative to allocating cash value more aggressively. Whether funding on a single premium basis or over a lifetime, the economics of VUL with guaranteed premiums and guaranteed death benefits not only fund the "bet to die" immediate need, but additionally incorporate a "bet to live" opportunity.

Further, if the policy is funded in such a way as to avoid what is termed a modified endowment contract rule, the trustee would have the ability to access policy values, including gains on a tax-free basis via withdrawals and loans. This feature allows the trustee to provide funds to the heirs while the grantors are alive, enjoying the sight of their family benefitting from their success.

Income taxes on retirement plans with VUL

Although many individuals are not subject to federal or state estate taxes, most have accumulated substantial IRA funds. For those who have minimal need to access retirement funds for lifestyle goals, income taxes on the passage of those assets to nonspousal beneficiaries may be significant. With the enactment of the SECURE (Setting Every Community Up for Retirement Enhancement) Act, the ability for a nonspousal beneficiary to spread the account value over life expectancy was eliminated and replaced with an acceleration of the tax over a maximum of 10 years. For those discovering this issue, a possible solution can be found in VUL. Applying the same features and benefits as discussed in the estate tax discussion above, you can proceed knowing that income tax-free insurance proceeds will be available to offset income taxes owed by your heirs. This planning may be especially important should you find yourself enjoying retirement in a state with no state income tax while your heirs reside in a state with significant income tax rates.

Summary

Individuals with federal or state estate tax liabilities — or those with significant IRAs or other "retirement plan" assets causing heirs to be subject to substantial income taxes — may wish to avail themselves of a VUL insurance policy, combining the "bet to die" protection with the "bet to live" opportunity.

[1] "Bet to Live, Bet to Die" created by Robert Keebler, CPA of Keebler & Associates, Milwaukee, WI.

[2] An irrevocable life insurance trust (ILIT) enables you to pass insurance proceeds to your heirs estate tax-free. It cannot be amended, revoked, or altered by the grantor once it is created. The assets in the trust are not included in the grantor's estate. The trustee may buy assets or lend money to the estate.

[3] IRS. All tax rates and exclusion amounts are as of January 1, 2024, and subject to change.

Important information

This material is for use with the general public and is designed for informational or educational purposes only. It is not intended as tax, estate or investment advice. Lincoln Financial Group® affiliates, their distributors, and their respective employees, representatives, and/or insurance agents do not provide estate, tax, accounting, or legal advice. Individuals should consult an independent professional as to any tax, accounting, or legal statements made herein.

Affiliates include broker-dealer/distributor Lincoln Financial Distributors, Inc., Radnor, PA, and insurance company affiliate The Lincoln National Life Insurance Company, Fort Wayne, IN.