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The Estate Planning Market Is *Grand!*

One of the best opportunities for selling life insurance in the post-EGTRRA world of estate planning is sales to grandparents for the benefit of their grandchildren.

Grandparents are great prospects because:

1. They are more likely to have funds to pay life insurance premiums.
2. They have special emotional bonds with grandchildren that make them open to increasing their grandchildren's financial security.
3. Reliable estate planning strategies are available to accomplish their objectives.

The Grandparent Market

The grandparent market is a big market and it's getting bigger. Demographic studies show that there are more than 70 million grandparents in the United States today. That's roughly one-third of the adult population. Experts expect this number to grow to 115 million by 2010. On average, people become first-time grandparents at age 47. Of course, once someone becomes a grandparent, they usually remain one for the rest of their lives.

The United States now has two generations of grandparents. Members of the World War II generation have had grandchildren for many years. Now baby boomers are becoming grandparents.

A significant number of these grandparents have money. The WWII generation is passing its wealth on to the baby boomers generation in what some authorities have called the greatest transfer of wealth in human history. At the same time, baby boomers are reaching the high points of their careers. They are reaching their peak earning years and many have significant amounts of disposable income. The American Society of Aging reports that people over 50 control more than $7 trillion in wealth; they own 77 percent of all financial assets and account for more than 50 percent of all discretionary spending.

The Special Bond. Grandparents and grandchildren share a close emotional bond. Each gets unique psychological benefits from the other. It is not uncommon to hear some grandparents say, "If I had known how much fun grandchildren would be, I would have had them first!" There are several reasons why these relationships are so strong.

- Grandparents don't have to be as concerned about discipline.
- Grandparents have fun spoiling their grandchildren and have money to do it.
- Grandparents may have a storehouse of knowledge on how to deal with children.
- Grandparents and grandchildren share a common enemy–the parents.
- Grandchildren give grandparents a chance to be young again.

Because of this unique bond, grandparents will sometimes do things for their grandchildren that they would never dream of doing for their children.

Why Do Grandparents Find Life Insurance Attractive? Life insurance is a financial tool with unique advantages. It can help grandparents meet their objectives without forcing them to make dramatic changes in their lifestyles or their wealth transfer plans. For many of them it will merely be a matter of adding a new component to their current plan. If they are insurable, all they need to do is create an irrevocable life insurance trust (ILIT) and transfer cash to pay policy premiums. With life insurance, a policyholder can provide these benefits: leverage premium payments into larger death benefits; put the funds represented by the policy face amount on "reserve" with down payment (first premium) and a series of installment premium payments; and create tax-advantaged benefits.

Why Should a Trust Own the Life Insurance Policy?

A trust isn't required, but often it is preferable. Grandparents can buy life insurance and name their grandchildren as beneficiaries. Sometimes this is appropriate; however, in most situations, this approach won't meet the grandparents' objectives. Multi-generation trusts give grandparents the opportunity to accomplish several additional objectives.

- Pay benefits to both children *and* grandchildren.
- Protect the benefits from creditors' claims and divorce settlements.
- Avoid transfer taxes (the death benefits can be insulated from estate and generation-skipping taxes for several generations).
- Control the future of assets while they remain in the trust and influence the behavior of beneficiaries.
- Secure professional management services to administer the assets.

The Generation-Skipping Transfer Tax and Exemption

Congress has decided to collect an estate tax every time wealth passes from parents to children (either during life or at death). Some wealthy parents avoid estate taxes by passing their property in trust so it "skips" over the children and passes on to grandchildren and great-grandchildren.

Congress created the generation-skipping transfer tax (GST) to prevent people from avoiding estate taxes in this way. However, Congress wanted this tax to apply to large asset transfers only, thus it created an exemption ($1.5 million in 2004 and 2005) so that "small" transfers could avoid the GST tax. Grandparents can apply part of their GST exemptions to shelter gifts from GST taxes. If the GST exemption is applied to gifts of an ILIT, the benefits it pays to grandchildren or younger family members should be GST tax-free.

The GST tax exemption is potentially a very valuable estate tax planning tax break. Because the marginal rate applied in the calculation of the estate tax is so large (37 to 55 percent depending on the size of the estate and the year in which the property owner dies), its ability to shelter growth in the estate from future transfer taxes can be very important. The impact on family wealth is remarkable when estate taxes are levied at the death of each generation. The ability to avoid significant amounts of estate tax for several future generations can be extremely valuable. There is great opportunity for financial professionals here because the GST exemption is often overlooked. Using it with life insurance can provide dramatic results.

The Rockefellers and the Smiths

From a prospecting perspective, there are two general types of grandparent prospects. The Rockefellers represent the upper level of wealthy grandparents. They often want to design their estate plans to maximize the benefits passed on to younger family members. This can include generations beyond their grandchildren.

Generally, the Rockefellers have net worths in excess of $5 million and are likely to have an estate tax problem. Their goals are to insulate their wealth from potential losses caused by estate taxes and claims of creditors and also to create an environment in which their wealth will grow over time.

The Smiths represent the lower level of wealthy grandparents. These are well-to-do grandparents who have more money than they will need for the balance of their lives. They are well off financially, but they are not wealthy. Generally, their net worths are between $1 million and $5 million, and they may not have an estate tax problem. They want to bolster their children's and grandchildren's financial security, and they want to leave a long term legacy.

Rockefeller Life Insurance Sales Opportunities. Rockefeller grandparents want to maximize family wealth over several future generations. They are willing to use all legal tools at their disposal to maximize family wealth. They may be excited to see how they can combine a multi-generation ("dynasty") trust, life insurance and their GST lifetime exemptions to increase their family's wealth.

Consider explaining these opportunities to grandparents who are Rockefellers.

- **Leveraging One or Two GST Exemptions.** How much death benefit can one or two GST exemptions buy? That's what wealthy clients want to know. A grandparent creates an ILIT to leverage his (and perhaps also his spouse's) GST exemption. This can be done in either of two ways.

1. Both grandparents make annual exclusion gifts to the ILIT that will cumulatively equal their combined GST exemption amounts after the last grandparent dies (e.g., $150,000 annually for 20 years).
2. Both grandparents make lifetime transfers of $1 million to the ILIT in lump sum gifts (or they split a $2 million gift from one of them) between husband and wife and make additional annual exclusion gifts to use the balance of their GST exemptions. Both grandparents allocate their GST exemptions to these gifts. All gifts are used to pay life insurance premiums. The ILIT purchases a second-to-die policy insuring both grandparents and paying death benefits at the survivor's death.

- **A Cristofani ILIT.** This is an ILIT funded with annual exclusion gifts like those in *Cristofani versus Commissioner 97-TC 5 (1991).* In that case, Mrs. Cristofani set up a trust to benefit her children. She funded the trust with annual exclusion gifts to her children and all her grandchildren. Outside of the temporary Crummey withdrawal power, the grandchildren couldn't get any money from the trust unless a parent died before them. In other words, they had to live past their parent's death in order to receive a share of the trust. The IRS challenged her ability to use the gift tax annual exclusion for these gifts to the grandchildren. The IRS lost this case and has since lost two more like it.
- **An Incentive ILIT to Encourage**

Positive Lifestyles. Some grandparents are reluctant to make transfers to their grandchildren because they fear they will have too much money at too early an age. They're afraid their grandchildren's drive to work hard and to make their own success may be compromised. Fortunately, an ILIT can be structured to avoid "spoiling" its beneficiaries. The grandparents can design it so that distributions are contingent rather than automatic. That means that the beneficiaries aren't guaranteed money from the ILIT.

The trustee can be instructed to pay out funds to beneficiaries who have "earned" distributions. In the trust agreement, grandparents establish the guidelines that beneficiaries will have to satisfy before the trustee can distribute trust funds to them. By deciding which actions of beneficiaries to reward with distributions, they may be able to influence the lifestyle choices the beneficiaries make. The opportunity to receive money from the trust can guide them toward behaviors the grandparents want to encourage.

Smith Family Life Insurance Sales Opportunities. The Smiths are symbolic of grandparents who are well-to-do, but not wealthy. They are neither worried about maximizing their tax breaks and getting maximum leverage out of their assets, nor are they interested in long term dynasty strategies that will last for generations. They love their grandchildren, but they love their children, too. They are more likely to implement strategies designed to benefit both their children *and* their grandchildren. ILITs can be designed to assist both generations.

• **The Family Safety Net.** Grandparents understand that today's world is very different from the world in which they grew up and made their fortunes. They understand that today there is global competition and that jobs don't last for a working lifetime. They've seen people get laid off and they've seen benefits and health insurance cut back and discontinued. They know that unexpected accidents, injuries and disease can turn the financial security of bright, successful people upside down. They've seen financial devastation in their friends' families and perhaps even in their own.

What can they do to increase their children's and grandchildren's financial security? They can create a financial safety net that may be able to help out any family member who needs temporary financial assistance. A family safety net can be structured as an ILIT which owns life insurance on either or both grandparents.

The death benefits are paid to the ILIT income, estate and GST tax free. The trustee can be directed to pay out funds to children or grandchildren as needed for their health, education, support or maintenance. Benefits can be limited to a period of time (e.g., three years) or to a maximum amount. Such limits can prevent one branch of the family or one family member from receiving a disproportionate share of the trust.

The Survivor Standby Trust. Some grandparents are eager to help children and grandchildren with financial security, but may not feel they can afford to make any substantial gifts. They fear they may need the money themselves some day, so they may be willing to purchase life insurance if they don't have to put it away in a trust where they can't get at it. They want the flexibility to change their minds if they need the money. The survivor standby trust (SST) strategy may work perfectly for grandparents in this situation.

The SST is a strategy for the personal ownership of a life insurance policy that can provide both personal and estate planning benefits. It requires two people (usually spouses) to implement. The strategy has four steps.

1. The spouse most likely to die first (the oldest or least healthy) is the owner and beneficiary of a single life policy insuring the other spouse or a second-to-die policy insuring them both. The owner pays the premiums out of personal funds. The owner can access policy values as needed.

2. The owner creates a "standby trust" to serve as the policy's contingent owner after his death. This trust can be created while the owner is alive or it can be in his will. It is similar to the unified credit shelter trusts that many clients have in their wills.

3. If the policyowner dies first, the standby trustee becomes the policyowner and beneficiary.

4. When the remaining spouse dies, the death benefits are paid to the standby trust, free of income and estate taxes.

The SST strategy gives the policyowner access to all policy values as long as he lives. Since he owns the policy, no gifts are made. At death, the policy's cash values are included in his taxable estate; however, the policy death benefits are not, because the last insured hasn't died. Grandchildren can benefit from the policy if they are named as beneficiaries of the standby trust. Distributions from the trust to the grandchildren can be GST tax free if the owner's GST exemption is allocated to the policy cash values at the time of death. If this is done, the entire death benefit should be GST tax free.

Passing on the GST Exemption at a Discount. The GST exemption is $1.5 million in 2004 and 2005. Some well-to-do grandparents may be willing to create a fund for their grandchildren, but they may not be willing or able to transfer this much money. Instead, show them how they can transfer $1.5 million at a "discount."

Explain to the grandchildren how the death benefits from a life insurance policy in an ILIT can provide the full $1.5 million. However, rather than transferring $1.5 million into the trust, only the policy premiums need to be contributed. These policy premiums will likely total substantially less than $1.5 million—*that's the discount.*

If they like discounting $1.5 million, they may be open to discounting death benefits of $2 million or $3.5 million. These are the amounts the GST exemption goes up to in 2006 and in 2009, respectively.

Tremendous Potential

The grandparent market has tremendous potential for new life insurance sales. The opportunities will only increase as the number of grandparents grows and their financial situations get stronger. The love between grandparents and their grandchildren is a timeless bond.

Life insurance death benefits can give Rockefeller grandparents and Smith grandparents attractive ways to enhance financial stability and create legacies for their grandchildren that last long into the future.