

The Role of Life Insurance in Legacy Planning

Life insurance plays an important role in legacy planning because of its unique features:

- **Self-Completion/ Immediate Cash:**
 - The policy's death benefit is paid in cash upon the death of the insured (for single-life coverage) or upon the death of the survivor-insured (for survivorship coverage) if the contract is in force, regardless of the policy year.
 - Provides a "time hedge" for other estate tax "freeze" strategies to work.
- **Tax Efficiency. If positioned properly:**
 - The death benefit is free of income, estate and generation skipping tax, *pursuant to IRC Sec. 101(a)(1-2), and 101(j)*.
 - The cash value accumulates income tax free.
 - Cash value withdrawals are treated on a first-in-first-out (FIFO) basis, therefore cash value withdrawals up to the total premiums paid are generally income-tax free.
 - Policy loans are income tax free.
 - A life insurance policy may be exchanged for another life insurance policy (or for an annuity) without incurring current taxation.
- **After-Tax Death Benefit Rate of Return (*higher for life insurance than assets of comparable risk*):**
 - Upon pre-mature death: Significant.
 - At life expectancy: Ranges from 4% to 5.5% *guaranteed* for no-lapse guaranteed coverage. (This is a guaranteed pre-tax equivalent of 6.66% to 9.16%, assuming a 40% income tax bracket).
 - At life expectancy + 5 years: Ranges from 3% to 4% *guaranteed* for no-lapse guaranteed coverage. (This is a guaranteed pre-tax equivalent of 5.00% to 6.66%, assuming a 40% income tax bracket).

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- Provides tax-free cash to pay federal and state estate taxes (due within nine months of death), eliminating the need to sell illiquid assets such as real estate, business interest, farms, art collections, etc. (possibly at "fire sale" prices) and preserving the estate for loved ones.
- Prevents a forced liquidation of concentrated stock in a down market to pay estate taxes.
- Provides tax-free cash to pay estate taxes on low-basis assets that are intentionally held in the taxable estate to give heirs a "step-up in basis" for capital-gains tax purposes.
- Offers non-spousal beneficiaries of large, qualified plan accounts a tax-free death benefit, avoiding the high marginal income tax rates imposed by the SECURE Act on inherited qualified plan assets.
- Mitigates potential future conflicts among surviving heirs by providing tax-free cash to "equalize" the inheritances of children who will not inherit an interest in illiquid assets (e.g., a business, farm, real estate, heirlooms, etc.)
- Encourages harmony among a new spouse, children and stepchildren by providing the necessary cash to "level out" inheritances.
- Offers parents reassurance that they can enjoy their wealth during their lifetime (and spend-down their wealth to cover expenses for quality long-term care), since their children and chosen charities will receive a lasting legacy through a life insurance death benefit.
- Leverages assets to provide a meaningful inheritance and legacy to all descendants (while replacing wealth left to charities, if applicable).
- Secures the future of children and grandchildren with special needs who are unable to care for themselves.

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- Provides cash to repay debt and to continue the accustomed lifestyles of surviving family members.

Life Insurance Funding Sources and Strategies

- **Sources**

- Existing Trust Assets or Income-Generating Property
- Proceeds From a Value-Realizing Event (sale or IPO).
- After-Tax Distributions from Qualified Retirement Plans.
- Existing Funded Trusts/ GRAT Remainder
- Business Paid Premiums (Executive Bonus / Split Dollar)
- Funds from Generational Trusts
- Funds from Children's Funds (GRAT Enhancement)
- Commercial Premium Financing
 - Local Banking Relationship
 - Bank Specializes in Premium Financing
 - Intermediary
 - Dual Loan

- **Strategies**

- Gifts
 - Annual Exclusion Gifts - \$19,000 per donee (2025)
 - Lifetime Exemption Gifts - \$15 million per person and Generation Skipping Tax Exemption
 - Transfer Assets:
 - Discounted Gift to a Defective Grantor Trust
 - Sale to an Intentionally Defective Grantor Trust (IDGT) (Gift and Loan Combination)
 - Discounted GRAT
 - Intra-Family Loans at the Applicable Federal Rate (AFR)
 - Self-Cancelling Installment Notes (SCINs)
 - Advanced Split Dollar Structures
 - Split Dollar – Economic Benefit Regime
 - Split Dollar – Loan Regime
 - Switch Dollar
 - Side Fund Split Dollar & Gift
 - Split Dollar Demand Loan
 - Pay Gift Tax
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What's the Urgency?

- Health may deteriorate and long term effects of COVID.
- Insurance pricing is increasing.
- Some life insurance products will no longer be available.
- Medical underwriting takes 6 – 12 weeks.
- A Trust requires legal counsel which can take 4 – 6 weeks.

Endnotes

For federal income tax purposes, life insurance death benefits generally pay income tax-free to beneficiaries pursuant to IRC Sec. 101(a)(1). In certain situations, however, life insurance death benefits may be partially or wholly taxable. Situations include but are not limited to: the transfer of a life insurance policy for valuable consideration unless the transfer qualifies for an exception under IRC Sec. 101(a)(2) (i.e., the transfer-for-value rule); arrangements that lack an insurable interest based on state law; and an employer-owned policy unless the policy qualifies for an exception under IRC Sec. 101(j).

Important Disclosures

This document is designed to convey accurate and authoritative information concerning the subject matter covered and should not be construed as tax or legal advice. Likewise, information supplied by life insurance companies and other sources is believed to be accurate. However, no information is guaranteed unless labeled as such. Information is provided with the understanding that Gateway Financial Group, Inc. does not engage in the practice of law, or give legal, tax, accounting, or investment advice. For advice in these areas, including the attached information and its application to specific transactions, please consult your appropriate advisors.

Life insurance policies include certain non-guaranteed elements, including premiums, credited interest rates, values, charges, etc. Non-guaranteed elements are not guaranteed by definition. As such, life insurance carriers reserve the right to change or modify any non-guaranteed element. This right to change non-guaranteed elements is not limited to a specific time or reason. Life insurance policies are issued by unaffiliated third-party insurance companies. Guarantees are based on the claims-paying ability of the issuing insurance company.

It should be understood that policy performance may be affected either positively or negatively, by changes in market conditions, including interest rates and equity valuations (if applicable), by premium payment amounts and frequencies, and by policy charges.

When considering the purchase of a no-lapse guarantee policy, policyowners should consider the value of higher non-forfeiture benefits versus the level of the premiums required to keep their insurance coverage in force. The death benefit guarantee provided by a no-lapse guarantee product is subject to the claims-paying ability of the issuing insurance carrier.

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