WRMarketplace
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The *WRMarketplace* is created exclusively for AALU Members by the AALU staff and Greenberg Traurig, one of the nation's leading tax and wealth management law firms. The *WRMarketplace* provides deep insight into trends and events impacting the use of life insurance products, including key take-aways, for AALU members, clients and advisors.

TOPIC: I Can't Take It With Me, But Can I Give It Away? Transferring Shared Family Assets - Fundamental Questions, Practical Solutions.

MARKET TREND: Many families wish to pass along family assets, like private equity, family compounds, or art collections, through multiple generations.

SYNOPSIS: Sustaining family assets (e.g., vacation homes, private equity, art collections, etc.) over multiple generations presents unique challenges, including realistic assessments about the family's overall commitment to maintaining the assets, equalizing benefits among participating and non-participating family members, considering and designing a proper governance structure, and funding for on-going asset maintenance.

TAKE AWAYS: Clients can protect shared family assets, strengthen governance structures, and minimize family conflict by incorporating life insurance into the plan. Life insurance offers a relatively simple solution to family equalization and liquidity management concerns, by eliminating tensions between family members and easing financial pressures placed on family asset decision-makers.

Many clients have an asset -- let's call it the "heirloom" -- which they would like to remain in the family for future generations, for example, a vacation home, private equity, an art collection, etc. Long-term planning for these assets, however, generates unique, practical challenges. Life insurance can play a key role in helping clients address many of these issues.

CASE IN POINT: THE SMITH FAMILY LAKE HOUSE

Mr. Smith and Mrs. Smith, both age 55, own a lake house in Maine, which was passed down through generations of Mr. Smith's family. Mr. Smith spent many summers there as a child, and he and Mrs. Smith took their children, Jack and John (twins), and Jane, to the house every summer when they were young. Mr. and Mrs. Smith, and Jack, John and their families still regularly use the lake house, but not Jane, as she lives in California and finds the travel inconvenient. The Smiths have improved the lake house significantly over the years and expect the house to be worth about $1.5 million after they pass. The Smiths want the family to retain the lake house for years to come as a place for family gatherings that promote family unity and kinship.

FAMILY ASSET PLANNING: 4 FUNDAMENTAL QUESTIONS

Before jumping into the tax or technical aspects of planning, clients like the Smith Family need to address certain practical issues to ensure they create a structure that will sustain the heirloom.

1. The Reality Check: Does the Family Really Want the Heirloom? Clients must realistically assess whether their future visions for the heirloom match their families' desires. Thus, clients should communicate honestly and clearly with family members to ascertain their actual interest in and commitment to the heirloom.

2. The Equalization Conundrum: Who's In and Who's Out? Even if a client's family wants to keep an heirloom, not all family members may be interested. Clients should determine who wants to participate in the heirloom and, if some do not, whether equal treatment of all family members is important.

3. The Control Challenge: Who Decides and How? Clients envisioning multi-generational maintenance of an heirloom will need a governance structure that consolidates ownership, identifies decisions-makers, sets forth a succession procedure, and provides flexibility.

Entity Selection. Consolidating or maintaining ownership of the heirloom in a single entity (e.g., trust, LLC, corporation) provides a legal framework for governance and prevents fractionalization of direct ownership interests in the heirloom over the years.

Family Goals & Values. The clients' provision of a concise expression of their goals for the heirloom, such as with a mission statement, letter of wishes, etc., can serve as a reminder of those goals and help rationalize the legacy plan for future generations.

Decision Structure & Succession. This is the heart of family governance planning and will require the most client input and thought, including with regard to the following:

- Who will make decisions regarding the use, distribution, or disposition of the heirloom? How are those decision-makers selected and replaced?
- How are decisions made, by majority vote, unanimous vote, etc.?
- Should independent (non-family) members participate in certain decisions? How should those independent members be chosen?

4. The Maintenance Problem: How Does the Family Sustain? Given their inherent illiquidity, few family heirlooms are entirely self-sustaining, often generating more expenses (taxes, maintenance, etc.) than cash-flow. Thus, heirloom planning generally requires a two-pronged gift: (1) gift of the actual heirloom and (2) gift of assets that can support the heirloom's maintenance. The liquidity planning becomes more complicated if the client wants to equalize non-participating family members with other assets.

Maintenance Needs. To determine the heirloom's liquidity needs, the client should assess the heirloom's burn rate and the value of assets needed to generate sufficient income to meet that rate for the desired number of years (the "**maintenance fund**").

Equalization Needs. To calculate equalization needs, the client should (1) add the value of the heirloom plus the maintenance fund, (2) divide that sum by the number of participating family members, and (3) multiply that amount by the total family members the client wants to benefit. For example, assume the Smith Family lake house is valued at $1.5 million and needs a maintenance fund of $3.5 million ($5 million total). $5 million divided between Jack and John is $2.5 million. So the Smith Family needs $7.5 million ($2.5 million x 3) to provide equal benefits to each of Jack, John, and Jane.

PUTTING IT ALL TOGETHER – THE SMITH FAMILY SOLUTION

The ability to generate liquidity will come at a premium when transferring heirlooms, which, as illustrated below, makes life insurance uniquely suited to this type of planning.

Goals. The Smiths wanted to (1) preserve the lake house for future generations, (2) ensure Jack, John and Jane are treated equally, (3) provide liquidity for estate taxes, expenses, and the lake house maintenance fund, and (4) minimize the administrative requirements of any lifetime planning. They had assets available for gifting and had not yet used any portion of their federal gift or generation-skipping transfer ("**GST**") tax exemptions.

Solution. Incorporating life insurance into the plan was a relatively simple answer to many of the Smith Family goals. The product selection factored in the Smiths' desire: (1) to minimize the need for additional premiums or other annual maintenance, (2) for sufficient death benefits to buy and support the lake house and to equalize Jane, and (3) for limited policy cash value or access during life.

Implementation.

Step 1: Mr. and Mrs. Smith created a long-term trust ("**dynasty trust**") for their descendants and included the following terms in the trust agreement:

- Ability of trustee to enter into transactions with the Smiths' estates, which allows the purchase of the lake house.
- Equal division of trust assets among Jack, John, and Jane after the Smiths' pass, with a request for allocation of the lake house equally to Jack's share and John's share.
- Creation of a "lake house committee," initially comprised of Jack and John, which provides guidance to the trustee on the use and management of the lake house.
- Appointment of an independent committee member, who can be removed and replaced by family committee members, and who votes only to break ties among family members.
- Removal and replacement of independent trustees by the committee.
- Buy-in option for Jane or her descendants, if they later decide they wish to participate directly with the lake house, based on terms suggested by the committee.
- Committee representation based on each participating child's line (Jack, John, and Jane (if she buys-in)). Each line's descendants vote to select their committee representative.
- Inclusion of a letter of wishes explaining the Smiths' vision for the lake house.

Step 2: The Smiths funded the dynasty trust with $2.5 million, using part of their federal gift and GST tax exemptions.

Step 3: The dynasty trust purchased a single premium, survivorship policy (MEC) insuring Mr. and Mrs. Smith with a face amount of $7 million and a premium of $2 million. To ensure sufficient death benefits, the policy included a return of premium rider that provided a death benefit equal to the face amount plus a percentage of the premium.

Step 4: After the death of the survivor of Mr. and Mrs. Smith, the dynasty trust uses the policy proceeds to buy the lake house from the Smiths' estate. If $7.5 million then remains in the trust ($1.5 million house and $6 million of insurance proceeds), Jane's share will be funded with $2.5 million in cash, while each of Jack's share and John's share will receive a $750,000 interest in the house and $1.75 million in cash for the house maintenance fund.

Bottom-Line: Objectives Met. A combination of life insurance funding and the establishment of a family governance structure helped the Smiths accomplish their primary objectives:

- As lifetime cash value was not an issue for the Smiths, the dynasty trust could buy a single-premium MEC (possibly a no-lapse, guaranteed policy), which avoided the administrative hassles associated with annual gifts and premiums (*e.g.*, Crummey notices to beneficiaries).

- Permitting the dynasty trust to use the insurance proceeds to buy the lake house from the estate will provide liquidity to cover estate taxes. Plus, the lake house should receive a basis step-up, which will be helpful should the family ever decide to sell the property.

- The plan will equalize the assets left to the Smith children, alleviating potential tensions regarding disposition of the lake house, while still offering flexibility for Jane and her descendants to participate in family reunions and to buy into the house later, if they desire.

- There should be sufficient insurance proceeds remaining for the lake house maintenance fund without exhausting other assets of the Smiths' estates. In the future, if consistent with the trust's overall investment plan, the trustee also could acquire life insurance on trust beneficiaries, which would provide later infusions of liquidity at their passing.

TAKE AWAYS

- Clients can protect shared family assets, strengthen governance structures, and minimize family conflict by incorporating life insurance into the plan.

- Life insurance offers a relatively simple solution to family equalization and liquidity management concerns, by eliminating tensions between family members and easing financial pressures placed on family asset decision-makers.

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