ADVANCED PLANNING

Survivorship Standby Trust

A SURVIVORSHIP STANDBY TRUST MAY BE RIGHT FOR CLIENTS WHO ARE MARRIED AND:

- Have a taxable estate with a need for survivorship life insurance coverage
- One spouse has an anticipated shorter life expectancy
- Want a strategy that will have the flexibility to respond to changes in tax and family circumstances

THE CHALLENGE

In a world of uncertainty, married couples may be reluctant to commit to irrevocable arrangements. Additionally, some are hesitant to establish an irrevocable life insurance trust (ILIT) because they may want to access their policies' cash values to help supplement their retirement incomes.[1]

If you work with married clients who want the flexibility to respond to changes in tax law or family circumstances, they may want to consider the Survivorship Standby Trust.

THE STRATEGY

The Survivorship Standby Trust is a technique designed to accomplish two objectives:

- Permit the insured to retain lifetime access and control over the cash value of a survivorship life insurance policy, and
- Avoid federal estate tax on policy proceeds at the death of the second insured.

Under this arrangement, the spouse with the anticipated shorter life expectancy is the owner and premium payer of a survivorship life insurance policy. The owner spouse creates a trust that is designated as the contingent policyowner and primary beneficiary. This trust will assume policy ownership on the death of the owner spouse.

The trust that is created and named as the contingent owner can be irrevocable at inception or be a revocable living trust that becomes irrevocable at the death of the owner. This trust is on "standby" and does not take ownership until the death of the owner; thus, it is known as the "Standby Trust."

By establishing ownership in this manner, the owner spouse has control of the policy, permitting them to be able to easily access the cash value within the policy to supplement retirement income if needed.[1] Assuming the owner does die first as anticipated, the survivorship life insurance policy passes to the trust as the named contingent owner. Provided the Standby Trust is properly drafted, the policy will then pass estate tax-free to the beneficiaries of the trust at the non-owner spouse's death, whenever that may be. Overall, this strategy can allow clients to have the survivorship life insurance coverage needed for estate tax liquidity, while also giving them control and flexibility to adapt to any changes that may arise.

BENEFITS OF A SURVIVORSHIP STANDBY TRUST

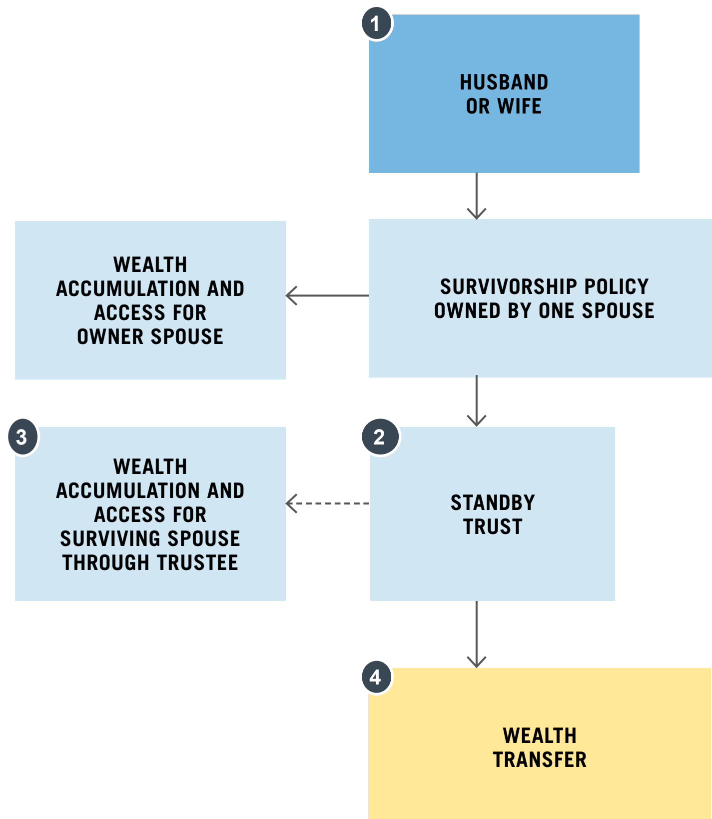
- **Estate tax-free death benefit**
  A properly drafted and funded Survivorship Standby Trust can ensure the death proceeds of a survivorship life insurance policy are received income[2] and estate tax-free and therefore provide for efficient wealth transfer to the clients' heirs.
- **Access to cash value**
  During life, the policyowner has full access to policy cash values, because the arrangement is not irrevocable until that person's death. Following the first death, the surviving spouse may receive distributions from the independent trustee of the "standby trust" for the remainder of their life or their spouse's life.[1, 3]
- **Flexibility**
  A properly drafted and funded standby trust protects the life insurance death benefit from estate taxes while allowing BOTH spouses access to the life insurance policy cash values.[1, 4] And, if the owner spouse outlives the non-owner spouse, they may gift or sell the policy to an ILIT or surrender it for cash.

KEY POINTS TO REMEMBER

A standby trust works only with survivorship life insurance. It is a strategy that allows a married couple to:

- Allow both the owner and non-owner spouses access to policy cash values either directly or through an independent trustee, maintaining flexibility in planning.
- Keep the death benefit proceeds free from income[2] and estate tax for beneficiaries.

HOW A STANDBY TRUST WORKS



1. The spouse with the anticipated shorter life expectancy applies for and owns a survivorship life policy insuring both spouses. As the policyowner, they have full control of the policy and access to its cash values.
2. On the death of the owner spouse, the policy passes to the Standby Trust because it is named as a contingent owner. The surviving spouse is a trust beneficiary.
3. If the owner spouse dies first, an independent trustee of the Standby Trust can make distributions to the surviving spouse during that person's remaining lifetime, providing the non-grantor spouse with indirect access to policy values in the trust.[1, 5]
4. The standby trust receives the death benefit free of both income and estate taxes when the surviving spouse dies.[2] The trustee administers the trust for the beneficiaries in accordance with the terms of the trust document. The death benefit paid to the trust beneficiaries will be free from both income[2] and estate tax.

CASE STUDY: MICHAEL AND CARLA

Michael and Carla are a married couple, both age 45.

In the event of the death of both Michael and Carla, the children would be financially protected by the policy's death benefit.

NEED

At their death, Michael and Carla's estates may be subject to estate taxes. They would like to implement a strategy that uses life insurance to provide the liquidity they need to fund transfer taxes and/or to equalize an inheritance.

During underwriting it is revealed that Michael, though insurable, has a mild chronic condition that he expects will result in Carla outliving him. For this reason, the flexibility of the Survivorship Standby Trust strategy interests them. For underwriting purposes (pricing a policy), Carla is rated **Preferred, Non-Tobacco** and Michael is rated **Standard Non-Smoker**.

GOALS

- When they die, transfer a portion of their wealth in a tax-free manner to their heirs
- Should they need it, have the flexibility to access their assets while they're living

STRATEGY

If a life insurance policy is personally owned, the death benefit may be subject to estate taxes upon the death of the surviving spouse. But since Carla can reasonably expect to outlive Michael, he can own the life insurance policy and pass it to a Survivorship Standby Trust for Carla's benefit as part of his estate, thereby keeping the future death proceeds out of Carla's taxable estate.

In the meantime, Michael can exercise full control over the policy during his life, and access its cash value directly.[1]

If Carla dies first, Michael can gift the policy to an irrevocable life insurance trust (ILIT) for the benefit of the couple's two children, and keep the death benefit out of his estate.[4]

Michael decides to purchase a PruLife® SVUL Protector® life insurance policy on the lives of himself and Carla with a face amount of $2 million. Premiums paid to a personally owned policy are not considered gifts. Michael decides to pay annual premiums of $20,000 for 20 years.

By the time Michael retires in 20 years at age 65, the policy's cash value is projected to be $636,430, based on a 7.00% rate of return (6.21% net) and current charges.

Based on a 0% rate of return (-1.05% net) and maximum charges, by the time Michael retires at age 65, the policy's cash value is projected to be $184,635 and coverage will not lapse through age 120.

This is a hypothetical example used for illustrative purposes only to describe how the strategies may work. Which strategy works best for clients will depend on their individual facts and circumstances. Actual results will vary.

RESULT

During Michael's lifetime, he has control of the policy and access to its cash value. When he dies, policy ownership passes to his Standby Trust for the benefit of Carla and the children. The trustee of this trust could make distributions, according to the terms of the trust, to Carla from the policy's cash value for retirement income or other financial needs.[1, 4]

But if Carla dies before Michael, he can gift the policy to an irrevocable life insurance trust (ILIT) for the benefit of his children to keep the future death proceeds outside of his taxable estate. Depending on the value of the policy, he may have to use a portion of his federal exemption amount for estate and gift tax purposes.[3]

BENEFITS OF THE SURVIVORSHIP STANDBY TRUST

- Flexibility to revise or terminate the arrangement during the lifetime of both insureds
- Control over the policy during the lifetime of the owner spouse
- Access to policy values to help supplement income[1]
- Avoidance of gift taxes during the lifetime of the owner
- Estate tax-free death proceeds for estate liquidity

LEARN MORE

Reach out to your Prudential representative for more information on how a Survivorship Standby Trust strategy can help you start a meaningful conversation with affluent clients.

[1] Cash values are accessed by loans and withdrawals, which will reduce policy cash values and the death benefit and may have tax consequences.

[2] Per IRC Section 101(a).

[3] If an insured gifts a life insurance policy in which they are the owner/insured and the death benefit is payable by reason of death within three years of the transfer, the proceeds are included in the insured's estate for estate tax purposes. There may be federal gift tax consequences associated with the funding of an ILIT.

[4] Access to any policy cash values is subject to the terms of the trust. To avoid giving the non-grantor beneficiary spouse any incidents of ownership in a trust which owns a survivorship policy, the authority to make distributions to the non-grantor beneficiary spouse may be limited to an independent trustee with absolute discretion. The non-spouse beneficiary should not have any rights or powers under the terms of the Survivorship Standby Trust which could cause inclusion of the policy in their estate. A client's attorney must draft the appropriate provisions based on the specific client needs and circumstances.

[5] If a Survivorship Standby Trust owns a survivorship policy and premiums are still due at the death of the grantor spouse, the trust will need funds to continue to pay the life insurance premiums. The non-grantor spouse cannot make direct or indirect contributions to the trust. Clients should plan ahead and discuss with their own legal counsel on how to plan for this contingency. One strategy may be for the grantor spouse to leave a testamentary bequest to the Survivorship Standby Trust.

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