PLAN FOR SCHEDULED 2026 TAX LAW CHANGES WITH LIFE INSURANCE

The current and historically high federal gift and estate tax exclusion and the corresponding exemption from generation-skipping transfer tax (GSTT), sometimes individually or collectively referred to as transfer tax(es),[1] may prove to be a once-in-a-lifetime opportunity to tax-efficiently pass significant wealth to children, grandchildren, and more distant generations. Using life insurance in your wealth transfer plan can potentially increase the amount passing to your family members and boost tax efficiency.[2]

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Time May Be Running Out

The Tax Cuts and Jobs Act of 2017 (TCJA)[3] effectively doubled the gift and estate tax exclusion and the GSTT exemption (for ease of reference, collectively referred to as exclusions or exclusion amounts) from the limits in effect prior to its passage in 2017. The exclusion amounts for 2025 are $13.99 million per person[4] ($27.98 million for a married couple).

The increased exclusion amounts, however, are not permanent. Assuming no changes to the law, the current exclusion amount (as further adjusted for inflation) is set to expire on December 31, 2025.[5] Beginning January 1, 2026, the exclusion amount will be decreased to $5 million, indexed for inflation. Although the exclusion amount in 2026 had been projected to be approximately $6.4 million,[6] increased inflation may cause that estimate to be low. Although an estate plan should not be based solely on potential taxation, consideration should be given to using the currently high exclusion amount now, while it remains available.

Much has been written about taking advantage of the increased exclusion amount by application of both time-tested and novel wealth transfer planning strategies, before it is reduced on January 1, 2026. This article focusses on using the increased exclusion amount to incorporate or support a life insurance strategy in your plan. Doing so may be a great way to leverage your exclusion amounts, without jeopardizing other planning goals. Of course, each family and its planning goals are unique. A plan that works for one family may not be appropriate for another. Accordingly, it is not possible to discuss every possible way to incorporate life insurance into a plan. Nevertheless, following are some ideas to consider with your advisory team.

Life Insurance, Generally

In general, there are two major categories of life insurance.

Term Insurance

Term insurance provides a death benefit should the insured die during a specific period of time, or term. Some policies of term insurance can be continued after the term, but at an increased premium cost. Additionally, some term insurance policies can be converted to permanent policies (described below) at the then-cost of permanent insurance based upon the insured's attained age but without the need for additional underwriting.

"Permanent" Insurance

Permanent insurance is a colloquialism for many different types of policies, such as whole life insurance, variable life insurance, universal life insurance and index life insurance. Each policy type has specific attributes and benefits, which can vary widely from policy to policy. Often, a policy of permanent insurance will build cash value inside the policy, which may be necessary to support the policy's death benefit, especially in the policy's later years. Generally, the cash value that builds up inside a life insurance policy is the cumulative amount of the premiums paid by the owner of the policy, plus return on investment, less the costs to maintain the policy (the cost of maintaining the death benefit, administrative costs and other charges). The policy owner may access this cash value during the insured's life. However, depleting the cash value could cause policy guarantees, or the insurance coverage itself, to lapse and potentially cause an income tax.

The Advantages of Life Insurance

Life insurance is purchased for many reasons. For a typical family, a policy death benefit can replace wages lost when a working spouse dies, pay off a mortgage so that a surviving spouse can continue living in the family residence, or allow for children to achieve their educational goals if one or both parents die. For a family of substantial wealth, a policy death benefit could be used to pay estate or inheritance tax, provide liquidity to prevent a forced sale of assets or equalize the value of transfers among beneficiaries. Whatever its use, a life insurance death benefit is a way to augment the amount of wealth passing to your beneficiaries.[7] Nevertheless, it is important to remember that your circumstances will differ from those of everyone else. A plan that works for one person may not work for you.

Life insurance is a tax-favored asset which enhances its use as a method to transfer wealth.[8]

Income Tax

As described above, certain permanent policies of life insurance can accumulate cash value. Some permanent policies allow the owner of the policy to invest the policy's cash value. Value that accumulates inside a life insurance policy is not subject to income tax.[9] This may allow the investments inside the policy to grow more quickly than investments that are subject to income tax.

Unless certain exceptions apply, the death benefit from a life insurance policy is not subject to federal income tax.[10] Some permanent policies add the policy's cash value to the death benefit. In that case, following the death of the insured, the beneficiaries of the policy will receive the stated death benefit plus the value of the policy's investments income tax-free.

Federal Estate Tax

If the policy is owned by someone other than the insured (such as an irrevocable life insurance trust (ILIT)), the insured has no incidents of ownership in the policy, and the death benefit is not payable to the insured's estate, then the death benefit will be paid free from federal estate tax.[11]

In short, it is possible for the beneficiaries of a life insurance policy to receive a tax-free cash death benefit following the death of the policy's insured.

GSTT

Although this article does not focus on the GSTT, whenever an ILIT is created and property is given to the trustee, generally, the allocation of GSTT exemption in the amount of the transfer will cause the trust to be wholly exempt from the GSTT.[12] In that case, the value of the gifted assets and any subsequent appreciation in their value could be exempt from future transfer tax for many generations.[13] Because the premiums paid are usually less than the value of a policy's death benefit, making an ILIT exempt from the GSTT may be a good way to leverage your GSTT exemption.

Using the Exclusion Amount with Life Insurance

Gifts to Pay Premiums

To keep a policy in force, the owner must pay premiums to the insurance company that issued the policy. To avoid the imposition of a federal estate tax on the death benefit, someone other than the insured should own a policy.[14] Often, to accomplish

this result, a policy of life insurance is owned by an ILIT. Although, ILITs are often created for the benefit of members of the insured's family, they can benefit others as well.

Transferring cash to an ILIT, so that the trustee can pay a policy premium, without more, would likely be a gift, potentially subject to gift tax. An ILIT can be designed so that cash gifts transferred to the trust qualify for the annual exclusion from gift tax. To qualify for the annual exclusion, a gift must be of a present interest in property, meaning that the beneficiary can access the gift immediately.[15] To qualify a gift in trust (where the beneficiary cannot immediately use the gift) for the annual exclusion, many trusts give the beneficiary the power to withdraw the gift only for a specific period,[16] after which the power expires.[17] However, a plan where gifts to an ILIT are limited to available annual exclusion amounts could limit the amount that can be given to the trust, which in turn could limit the size of the policy that can be purchased. Moreover, fully utilizing your annual exclusions to fund a life insurance trust would cause any other gifts made to the beneficiaries to use some your lifetime exclusion amount, or if your exclusion amount has been fully used, require payment of a gift tax.

If you wanted to create an ILIT to hold a policy larger than what can be supported by your annual exclusions, consider using the expanded lifetime exclusion amount to prefund an ILIT. The trustee could invest the amount transferred to the ILIT and the income and principal of the trust could be used to support the premiums on a life insurance policy.[18]

It is also possible to use the lifetime exclusion to salvage an insurance program that is underperforming. Like any financial asset, you should review your life insurance policies regularly to see if they are performing as expected. This is particularly true of policies that invest their internal value in mutual fund type investments or index fund type investments. You should also review traditional whole life policies, as there may be significant cash build up in the policy that is not being used efficiently. Some policies, such a non-guaranteed universal life policies and non-guaranteed variable life policies may expire should the policy's cash value drop to zero. If your policy has underperformed and it is possible that its cash value will run out, you may be able to exchange the underperforming life insurance policy for a new one (with better contract provisions) in a tax-free exchange.[19] However, it may be that your health has declined or you have aged sufficiently since you purchased the policy, that you are unable to purchase a new policy at a reasonable cost. In that case, you may be able to preserve the existing policy by a cash infusion. If the policy is owned by an ILIT, adding cash to the trust could be a gift (see above). However, application of your lifetime exclusion to the cash transfer would prevent that gift from causing a gift tax.

Supporting Other Plans

In anticipation of the scheduled reduction in the lifetime gift and estate tax inclusion in 2026, many people have created, or are considering creating, spousal lifetime access trusts (SLAT). At its most basic description, the SLAT strategy is a gift from one spouse (the donor spouse) to an irrevocable trust for the benefit of the other spouse (the beneficiary spouse) and, perhaps, others. The beneficiary spouse can receive distributions from the SLAT, yet the SLAT is designed to be excluded from the beneficiary spouse's gross estate and to not be subject to estate tax when the beneficiary spouse dies.[20]

Often, one of the factors considered when creating a SLAT is the ability of the donor spouse and family to indirectly access the funds in the SLAT through distributions from the SLAT to the beneficiary spouse. However, should the beneficiary spouse die before the donor spouse, distributions from the SLAT could no longer be paid to the beneficiary spouse (making them unavailable to benefit the donor spouse). To protect against the loss of indirect access to the funds in the SLAT caused by the beneficiary spouse's untimely death, the spouses could consider a life insurance back up plan. For example, the beneficiary spouse could create a separate ILIT to own a life insurance policy insuring the beneficiary spouse's life. The donor spouse would be a beneficiary of the ILIT. The ILIT could be funded (so that premiums can be paid) by annual exclusion gifts, use of the beneficiary spouse's lifetime exclusion amount (if any remains), or by a loan from the SLAT, other individuals, or entities.[21] In that case, the lost access to funds would be replaced by a new source of funds, the death benefit in the ILIT.

A similar approach could be used to protect against the early death of a non-charitable beneficiary of a charitable remainder trust (CRT).[22] Higher interest rates make CRT planning more effective. There are many reasons to create a CRT. One reason to do so, is to spread income tax liability out over the non-charitable beneficiary's lifetime. People who wish to benefit charity while deferring tax often use a CRT. For example, a CRT can be used as the beneficiary of a qualified retirement plan or IRA or to diversify an appreciated concentrated position.[23] However, should the non-charitable beneficiary die prematurely, the beneficiary's family will not receive the benefit of a long stream of payments, as the death of the beneficiary would cause any property in the CRT to be paid to the charitable beneficiaries. To protect the beneficiary's family from losing wealth intended to be received from a long-term stream of payments, the non-charitable beneficiary could fund an ILIT using some or all of the non-charitable beneficiary's exclusion amount.

Helping Others Plan

It is axiomatic that insurance premiums are lower for younger and healthier people. As we age, there comes a time when purchasing a policy of life insurance on our own lives becomes prohibitively expensive or unavailable. But even if you cannot purchase a policy of insurance on your own life, perhaps you can help your children (and even grandchildren) purchase insurance.

Although it may be easier (and less expensive) for younger family members to purchase life insurance on their own lives, they may lack the funds to purchase the appropriate or a sufficiently large policy. Here, the senior members of the family can help. For example, a person who has children and grandchildren could use their exclusion amount to fund a trust that benefits their child's descendants. The trustee could then leverage the gift by investing some (or all) of the gift in a policy of life insurance insuring the child's life. Upon the child's death, the death benefit would be available for the donor's grandchildren (and possibly more distant descendants). The donor must be careful to avoid the GSTT here, as without an allocation of GSTT exemption, property transferred to the trust could cause a GSTT.[24] Nevertheless, if done right, a senior family member can help provide financial security for their grandchildren and more distant descendants.

Tax-Free Investing

As stated above, cash value accumulates inside a life insurance policy without reduction for income tax, and if paid as part of the death benefit that cash value escapes income tax altogether. Furthermore, if the policy is owned in a properly constructed and administered ILIT, the death benefit (and any cash value included in the death benefit) will also escape the estate tax.

Usually, owners of life insurance policies look to buy the greatest amount of death benefit for the least premium cost. Nevertheless, there is a maximum amount that can be paid into a life insurance policy without triggering certain adverse income tax consequences (and creating a modified endowment contract).[25] Yet, consider what could happen if a policy owner contributed the maximum amount possible to a policy, while purchasing the least amount of death benefit necessary to support the premiums paid: The owner of the policy would have an investment fund that would grow without income tax and upon death would pay a cash death benefit plus the value of the accumulated policy investments without reduction for income or estate tax. This type of arrangement can be constructed through a private placement life insurance policy.

To create such a tax-free investment fund, you could contribute your available exclusion amount to an ILIT, which would then purchase a private placement life insurance policy insuring your life. The investments inside the life insurance policy grow without income tax, and when you later die, the death benefit plus the policy's cash value will be paid the trust, and benefit the beneficiaries, again without income or estate tax. If you are not able to purchase a policy on your life, as described above, you could create such a plan for a child, to benefit your grandchildren and more distant descendants.

Don't Go It Alone

Successful people have support networks, groups of professionals, friends, business associates and others with whom they can discuss ideas, plans and goals. Estate and financial planning are no different. PNC Private Bank® has professionals who can work with you and your legal, tax and other advisors to help you achieve your personal and financial goals. A PNC Private Bank Insurance Strategist can work with you and your other advisors with respect to your life insurance plan. To learn more about incorporating life insurance into your plan or to access any of PNC's resources, contact any member of your PNC Private Bank team.

Endnotes

1 For a discussion of gift and estate taxes and the generation-skipping transfer tax, see Title I, Subtitle A, Part VI: Increase in Estate and Gift Tax Exemption, Joint Committee on Taxation, General Explanation of Public Law 115-97, December 20, 2018, https://www.jct.gov/publications/2018/jcs-1-18/ (last accessed December 3, 2024).

2 PNC does not provide legal, accounting or tax advice. Your PNC Private Bank team will work with you, your attorney, accountant and other tax advisors as you consider whether and how to incorporate life insurance into your plans.

3 Pub. L. 115-97, 131 Stat. 2054.

4 Rev. Proc. 2024-40, 2024-45 I.R.B. 1100.

5 Internal Revenue Code (IRC) § 2010(c)(3)(C); see also, Joint Committee on Taxation, List Of Expiring Federal Tax Provisions 2022 – 2034, January 18, 2023, JCX-1-23, https://www.jct.gov/publications/2023/jcx-1-23/. (last accessed December 3, 2024); Congressional Research Service, Reference Table: Expiring Provisions in the "Tax Cuts and Jobs Act" (TCJA, P.L. 115-97), R47846, November 21, 2023.

6 Congressional Budget Office, Understanding Federal Estate and Gift Taxes, June 2021, https://www.cbo.gov/system/files/2021-06/57129-Estate-and-Gift-Tax.pdf (last accessed December 3, 2024).

7 One common use for life insurance is replacing wealth lost to estate and income taxes. Of course, replacing wealth paid to the government as taxes increases the amount passing to your beneficiaries.

8 This article discusses contracts that meet the definition of life insurance under IRC § 7702. A discussion of modified endowment contracts, as defined in IRC § 7702A, is beyond the scope of this article.

9 IRC §§ 72(e) and 7702(g).

10 IRC § 101.

11 IRC § 2042. However, the value of the death benefit from a life insurance policy transferred by the owner-insured to an ILIT (unless the insured receives adequate consideration in money or money's worth) will be included in the insured's gross estate and potentially subjected to estate tax if the insured dies within three years of the transfer to the ILIT. IRC § 2035. Many states impose an estate or inheritance tax. State taxes are not discussed in this article.

12 This discussion assumes a timely allocation of GSTT exemption.

13 Some states, like Delaware, in certain cases, allow trusts to last "forever." 25 Del. Code § 503. In other states, although trusts have ending dates, they are allowed a very long existence. For example, in Florida trusts created after December 31, 2000, through June 30, 2022, may exist for 360 years and trusts created on or after July 1, 2022, may exist for 1,000 years. Fla. Stat. §§ 689.225(2)(f) and (g).

14 See, note 11, *supra*.

15 IRC § 2503(b). For 2025, the annual exclusion amount is $19,000, except with respect gifts to a non-citizen spouse, in which case the annual exclusion amount for 2025 is $190,000. Rev. Proc. 2024-40, 2024-45 I.R.B. 1100.

16 Because the beneficiary has the right for some period of time to take the property gifted to the trust, that gift is a present interest in property that qualifies for the annual exclusion. *Crummey v. Comm'r.*, 397 F.2d 82 (9th Cir. 1968). This decision is the genesis of the eponymous "Crummey power."

17 Depending on the value of the trust, the lapse of the beneficiary's power to withdraw property from the trust could cause the beneficiary (even if the beneficiary is a minor) to make a taxable gift. Accordingly, care should be used when deciding when and how much of a beneficiary's withdrawal right should lapse in any one year. IRC § 2514(e).

18 Subject to exceptions, a trust whose income can be applied to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse is a so-called "grantor trust". IRC § 677(a)(3). If a trust that you create is a grantor trust, for federal income tax purposes you are treated as owning the assets of the trust. This means that income, gain, and loss realized by the trust will be taxed to you as if you owned the assets that generated such income.

19 IRC § 1035. Even in a tax-free exchange, you may consider adding additional cash (over and above the cash value of the old policy) when purchasing the new policy. For example, addition cash may be necessary to keep the same death benefit or, if desired, increase the death benefit.

20 Of course, each family and each family's plan are different. Trusts can be complicated and should not be entered into without obtaining advice. Creating any type of trust involves legal, tax and financial considerations. You should consult your legal, tax and other advisors to determine if creating a SLAT is right for your family and how creating a SLAT would impact your goals and plans.

21 Borrowing funds to pay for a policy of life insurance, particularly where a reasonable person would expect the debt to be paid from the death benefit, would likely cause the rules regarding "split-dollar" life insurance to apply. These rules are complex and nuanced and should be considered in any non-bank premium funding program. Treas. Reg. § 1.7872-15 (for split-dollar loans), Treas. Reg. § 1.61-22 (other split-dollar life insurance arrangements).

22 A CRT is a trust that provides one or more non-charitable beneficiaries living when the trust is created a stream of payments for life or (in other cases) a stream of payments for a term of no more than 20 years. At the end of this term, whatever is left in the CRT is distributed to one or more charitable organizations.

23 A CRT is a tax-exempt entity, giving appreciated property to a CRT, followed by a sale of that property, will not cause an immediate capital gain (although care should be taken to avoid application of the step-transaction doctrine). Similarly, as the CRT receives income from the qualified plan or IRA it will not pay tax on that income. Rather, any income realized by the CRT will be distributed to its beneficiaries over the trust's non-charitable term. If the CRT's term ends before the beneficiaries are taxed on all of that income, the untaxed income will pass to charitable organizations and escape tax.

24 See, generally, IRC §§ 2601, 2611, 2612 and 2613(a)(2). With respect to generation assignment, see IRC § 2651.

25 See IRC §§ 7702 and 7702A.

For more information, please contact your PNC Private Bank advisor.