

Why life insurance?

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THE CONTEXT



Permanent life insurance is the only asset class that can simultaneously deliver guaranteed wealth growth, complete income-tax and transfer-tax efficiency, and comprehensive risk mitigation, as part of a client's portfolio of legacy planning strategies. The success of traditional, wealth-transfer techniques depends on asset performance, investment horizon, and survival assumptions. **Life insurance does not.** Other techniques are taxable. **Life insurance is not.**

Wealth-transfer choices typically result in a tradeoff between minimizing transfer taxes, yet losing the basis step-up for income tax purposes. There's no such tradeoff with life insurance. Increasing gift-tax efficiency usually means applying steep valuation discounts based on qualified appraisals and aggressive tax positions, which the IRS routinely challenge. Alternatively, tax law expressly allows valuation discounts provided in private split-dollar arrangements, which enable families to transfer substantial wealth using only a fraction of their gift-tax exemption without high audit risk.

Only life insurance provides a guaranteed legacy, plus a complete:

1. Hedge against asset performance risk.
2. Hedge against mortality risk.
3. Exemption from *both* income tax and transfer tax.
4. Avoidance of the basis step-up tradeoff.
5. Gift-tax value discount.

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Life insurance is truly the only investment product that can lock in a family legacy. For successful families, the strategic use of permanent life insurance solves for the vulnerabilities inherent in even the most sophisticated wealth-transfer techniques. Some of them are listed below.

Performance risk immunity: Gifts and installment sales to grantor trusts, grantor retained annuity trusts (GRATs), and spousal lifetime access trusts (SLATs) – all require assets to appreciate faster than a “hurdle rate” to succeed. On the other hand, life insurance delivers a guaranteed face value, in cash, regardless of market performance. A family who executes a \$20 million sale to a grantor trust in exchange for a long-term note will have to achieve a 4.83% return just to break even (Aug. 2025 long-term, applicable federal rates). Outperforming the

hurdle rate typically means investing more aggressively and taking on more risk. The same family funding a \$20 million life insurance policy receives exactly that amount in the future, without performance risk and price volatility.

Mortality risk immunity: The success of staple advanced legacy planning strategies, including GRATs, charitable lead annuity trusts (CLATs), and qualified personal residence trusts (QPRTs) – depends on the client surviving the trust term. Premature passing results in a failed strategy. Life insurance rewrites the script. Consider a client implementing a 20-year QPRT designed to transfer appreciation on a family vacation compound. If the client dies in year 19, the asset returns to the client's taxable estate at its full, fair-market value, as if the QPRT were never created. Instead, by pairing the QPRT with a life insurance policy equal to the anticipated transfer, the family receives the intended wealth regardless of survival and performance. Life insurance recasts an uncertain gamble into a guaranteed outcome.

Income tax and transfer tax efficiency: Owning life insurance through a properly structured irrevocable life insurance trust (ILIT) offers a liquid, face-value benefit that's free from income tax and transfer tax, and the benefits of an ILIT can't be extolled enough. Private placement life insurance (PPLI) offers another compelling opportunity to convert taxable portfolios into tax-free growth vehicles with institutional-grade investments. A family investing \$10 million in private equity through a PPLI structure eliminates the income tax drag on returns while obtaining access to private funds typically reserved for multimillion-dollar capital commitments.

No basis-up tradeoff: Traditional gifting strategies necessarily involve a choice between, a transfer-tax savings from shifted appreciation and income-tax savings from a step-up in basis. Life insurance avoids this dilemma entirely. When a client transfers zero-basis founder's stock to an irrevocable trust, the client's descendants also inherit a lurking liability for capital gains tax. Purchasing a life insurance policy inside of an ILIT provides descendants with a guaranteed legacy without capital gains tax and allows the client to retain the business and receive a basis step-up.

Approved valuation discounts: Through economic benefit, split-dollar arrangements, families can fund large blocks of life insurance while minimizing gift-tax friction. Consider a married couple purchasing a \$30 million survivorship policy in an ILIT requiring annual premium gifts of \$250,000. Under a properly structured split-dollar arrangement, the annual gift to the trust is discounted to equal the policy's "economic benefit" – defined as the one-year term cost of insurance – which may be only a few hundred dollars. From a gift tax perspective, the clients transfer tremendous value for cents on the dollar, all sanctioned by the tax code (as opposed to potentially aggressive gift-tax valuation discounts based on appraisals).

THE CRITICS



Despite its compelling advantages, life insurance faces persistent misconceptions that prevent many families from appreciating its full value.

The IRR fallacy: Critics claim life insurance underperforms other investments, but they ignore the taxes and investment fees. To match an assumed 4.5% tax-free return of life insurance, a taxable asset would have to return at least 7%. Compare a \$5 million premium investment growing to \$12 million of face value over 20 years (4.47% IRR) to the same amount invested at a 7% annual return. The taxable asset grows to \$19.3 million but faces \$7.7 million in transfer taxes, netting only \$11.6 million to the family. The taxable asset ultimately returns less than the life insurance despite its higher stated return. When factoring in income taxes paid along the way, life insurance may generate alpha of more than 200 basis points.

The liquidity misconception: Wealthy families may believe their portfolios provide sufficient liquidity and that life insurance is unnecessary. This belief assumes the client will pass at a time when market conditions are favorable for selling assets to pay transfer taxes. The dot-com bust of the early 2000s, a financial crisis in 2008, and a health crisis in the early 2020s, all expose the danger of this assumption, when supposedly liquid assets become effectively frozen to avoid fire-sale pricing. Life insurance provides immediate cash exactly when needed – at passing – regardless of broader market conditions, asset valuations, or credit availability. This guaranteed liquidity prevents forced asset sales that can force the sale of family legacy assets and destroy previous wealth accumulation.

The complexity concern: Money managers may shy away from life insurance because they're unfamiliar with the nuances of product structures, pricing mechanisms, and fiduciary considerations. This knowledge gap deprives clients of optimal strategies. Modern institutional platforms now offer transparent pricing, clear compensation disclosures, and rigorous product selection processes that meet the highest fiduciary standards. Independent trustees routinely purchase life insurance after competitive bidding processes, demonstrating that complexity concerns reflect advisor limitations – not product deficiencies.

TOUCHPOINT



Life insurance stands alone in its ability to guarantee tax-free wealth creation without mortality and performance risks inherent in traditional legacy planning strategies, and without trading away a basis step-up. PPLI offers access to institutional-level funds inside an income-tax-free vehicle, while private split-dollar arrangements allow families to fund larger policies with less gift-tax exemption. For families who want certainty in a legacy plan, life insurance is the cornerstone of a truly integrated and risk-managed approach to multi-generational wealth preservation.

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