

# Encouraging Positive Behaviors Using an Incentive Trust

Using Life Insurance



**PACIFIC LIFE**

Pacific Life Insurance Company



### WHY AN INCENTIVE TRUST?

Families like yours want to provide financial security for their heirs. You may fear that a substantial transfer of wealth will neither promote positive behaviors nor reinforce values. That is why you may want to consider implementing an incentive trust funded with life insurance. The incentive trust may provide for your beneficiaries' health, education, support and maintenance, and may convey your values, foster education and encourage productivity. A life insurance policy inside an incentive trust provides death benefit protection against premature death and may be used for any estate tax liquidity needs.<sup>1</sup>

### PROMOTING POSITIVE BEHAVIOR

The goal of incentive trust planning is to ensure that inherited wealth creates a positive rather than a negative legacy. Incentive trust provisions may include: rewarding educational goals achieved such as earning a degree and/or maintaining a certain grade point average, recognizing work-related success by providing funds which match earnings, and providing additional income to a beneficiary who chose an important yet low-paying career. The choice of the incentives is limited only by the creativity of you and your advisors.<sup>2</sup> The terms of the incentive trust typically give the trustee broad discretionary distribution powers because, as time passes, your family's values as well as the beneficiaries' circumstances may change.

### PROVIDING WHILE ENCOURAGING POSITIVE BEHAVIOR

With the assistance of an attorney, you (the senior generation) create an irrevocable trust with appropriate incentive provisions to establish a values-based structure by which assets may be passed down to the younger generations. You transfer cash and/or income-producing assets to the incentive trust so that the trustee<sup>3</sup> can pay the life insurance policy premiums. Your ability to make annual exclusion gifts or to use the lifetime gift tax

exemption determines whether the transfers are subject to gift tax.<sup>4</sup> The trustee purchases a life insurance policy insuring the senior generation (you, or you and your spouse). The incentive trust becomes the owner and beneficiary of the life insurance policy. Upon the second death (or your death, if it is a single life policy insuring your life), the life insurance death benefit proceeds may be paid to the incentive trust free from estate and income\* taxes. The trustee will make distributions from the trust to the beneficiaries according to the terms of the incentive trust. Note that the use of incentive provisions is not limited to irrevocable life insurance trusts. Many types of trusts can incorporate incentive provisions, including: living trusts, spousal lifetime access trusts, B-Trusts (also known as bypass or credit shelter trusts), generation-skipping trusts and dynasty trusts.

\* 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).

1 According to the Tax Cuts and Jobs Act of 2017, the federal estate, gift and generation-skipping transfer (GST) tax exemption amounts are all \$10,000,000 per person (indexed for inflation effective for tax years after 2011); the maximum estate, gift and GST tax rates are 40%. In 2026, the federal estate, gift and generation-skipping transfer (GST) tax exemption amounts are scheduled to revert to \$5,000,000 per person (indexed for inflation for tax years after 2011).

2 Clients should not incorporate provisions into an incentive trust that violate public policy, encourage discord among beneficiaries, and/or make trust administration impossible.

3 The trustee appointed should not be the insured or the insured's life insurance producer. A life insurance producer who is paid a commission on the sale of a life insurance policy represents both his or her personal interest and the interests of the trust, creating a conflict of interest.

4 As of January 1, 2023, the annual gift tax exclusion is \$17,000 per donee (indexed for inflation).

**Pacific Life, its affiliates, their distributors and respective representatives do not provide tax, accounting or legal advice. Any taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor or attorney.**

## Clients/Insureds



## Incentive Trust



## Beneficiaries



## Life Insurance Policy

1

2

5

4

3

1

### INCENTIVE TRUST

Working with your attorney, you establish an incentive trust, which is an irrevocable trust containing appropriate provisions to convey your values, foster education and encourage productivity for distribution of assets to beneficiaries.

2

### CASH AND/OR ASSETS FUND THE INCENTIVE TRUST

You transfer cash and/or income-producing assets to the incentive trust. The cash and/or income-producing assets may qualify as annual exclusion gifts or may use your lifetime gift tax exemption, depending on how the transfers are structured.

3

### LIFE INSURANCE POLICY OWNED BY INCENTIVE TRUST

The trustee of the incentive trust purchases a life insurance policy insuring you (or you and your spouse). The incentive trust is the owner and beneficiary of this policy.

4

### LIFE INSURANCE DEATH BENEFIT PROCEEDS PAID TO INCENTIVE TRUST

At the second death (or your death, if it is a single life policy insuring your life), the incentive trust should receive the life insurance death benefit proceeds free from estate and income\* taxes.

5

### DISTRIBUTIONS TO BENEFICIARIES

The trustee will make distributions to the beneficiaries according to the terms of the incentive trust. The provisions of the incentive trust typically give the trustee broad discretionary distribution powers because, as time passes, your values as well as the beneficiaries' circumstances may change.



## The Power of Pacific



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*This factfinder is provided to help you and your life insurance producer better understand your goals and objectives. Please return the information to your life insurance producer and not to Pacific Life Insurance Company as we cannot and do not provide financial, legal or tax advice.*

VITAL INFORMATION

Client: \_\_\_\_\_ Date of Birth: \_\_\_\_\_

Address: \_\_\_\_\_

Spouse: \_\_\_\_\_ Date of Birth: \_\_\_\_\_

Client Risk Status:    ☐ Select    ☐ NS    ☐ S                      Spouse Risk Status:    ☐ Select    ☐ NS    ☐ S

Life Insurance Death Benefit Need: \_\_\_\_\_ State of Residence: \_\_\_\_\_

Illustrate Level or Increasing Death Benefit: \_\_\_\_\_

Premium Payment Mode: \_\_\_\_\_ Solve? \_\_\_\_\_ or Amount? \_\_\_\_\_

Anticipated Years to Pay: \_\_\_\_\_ Illustration Crediting Rate: \_\_\_\_\_ %

Life Insurance Product to Illustrate: \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

Attorney's Name: \_\_\_\_\_ Phone: \_\_\_\_\_

Address: \_\_\_\_\_

Accountant Name: \_\_\_\_\_ Phone: \_\_\_\_\_

Address: \_\_\_\_\_

Goals, objectives or behaviors to encourage in your heirs which should be discussed with the attorney: \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

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Life insurance is subject to underwriting and approval of the application and will incur monthly policy charges.

Investment and Insurance Products: Not a Deposit	Not Insured by any Federal Government Agency	
Not FDIC Insured	No Bank Guarantee	May Lose Value