

Explore, Inquire, Innovate

Dynamic Estate Planning With Life Insurance and

Other Assets

By: Alan S. Gassman, J.D., LL.M. agassman@gassmanpa.com

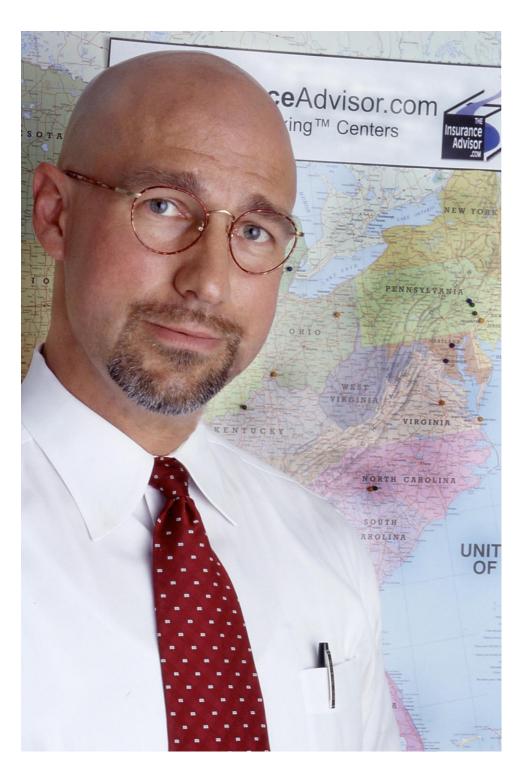








Special Thanks to Barry D. Flagg, CFP®, CLU, ChFC, GFS®, AEP®



Barry D. Flagg is the inventor and founder of Veralytic, the leading online publisher of life insurance pricing and performance research and product competitiveness ratings. Veralytic is the result of his unique background in both the fiduciary investment business where he became the now oldest, youngest Certified Financial Planner (CFP®) in history, and as a life insurance expert consistently recognized in the top 1% of the industry. He's renowned for applying Prudent Investor Principles to life insurance product selection or retention and portfolio management.

As a result, he serves as sub-advisor to thousands of irrevocable life insurance trusts (ILITs) as well as RIAs and wealth managers, is a contributing expert to CNN, Forbes, Insure.com, and USA Today among others, leads curriculum development and instruction for Applied Fiduciary Practices involving life insurance for The Center of Board Certified Fiduciaries at Wake Forest University, and serves as volunteer to the CFP Board Professional Standards and Legal Department for complaints involving life insurance. Barry has authored numerous articles for national publications on the management of life insurance as an asset according to established and proven asset management principles and frequently teaches continuing education courses about same to attorneys, CFP®s, CPAs, and CTFAs.

Barry's speaking and writing includes addressing the national conferences of the AICPA Personal Financial Planners (PFP), Ernst & Young Annual Family Office Accounting & Tax Education, Fi360, Financial Planning Association (FPA), Grant Thornton, Holland & Knight, HSBC Bank/WTAS, Notre Dame Tax Institute, the Academy of Financial Services (AFS), and many of the largest independent distributors of life insurance in the U.S. He has also been published by the ABA, AICPA, CCH, Fiduciary & Investment Risk Management Association (FIRMA) and Trust & Estates, cited by ALI/ABA reference text, guest lectured at Leadership Bootcamp for Life Insurance Stewards at West Point, Stetson Law, Texas Tech University and the Wall Street Academy, and appeared on national internet radio shows for a number of the largest insurers in the U.S.

Barry is also a Chartered Life Underwriter (CLU), Chartered Financial Consultant (ChFC) and Cum Laude graduate of the W. Paul Stillman School of Business at Seton Hall University. Barry has been on the CFP Board's Disciplinary and Ethics Commission, an adjunct faculty member of the College for Financial Planning, and is a member of the Financial Planning Association (FPA), and the Million Dollar Round Table (MDRT) Top of the Table continuously since 1993.





INTRODUCTION

Many policies have been put in place for the primary purpose of addressing estate tax issues, which no longer exist, and can be repurposed, and possibly changed, to become savings, Buy-Sell Agreements, and family bank vehicles.

Many Trusts that currently exist can be repurposed, and other Trusts can be minimized or eliminated, depending on what the optimal plan will be.

It is essential that there be tax, legal, investment, and life insurance expertise shared by a team of advisors, with one obligation being to help assure that the client or clients, and other involved family members and advisors, understand the options that exist, including all possible opportunities and potential disadvantages and traps for the unwary.

The Big Beautiful Tax Act will cause a great many life insurance policy owners to have different plans and strategies for ownership and use of life insurance policies compared to the situation before the Act was passed. This will primarily impact families that will no longer have imminent estate tax exposure, and in particular, those families who have life insurance or other assets under irrevocable trusts that no longer seem necessary for federal estate tax purposes.





Pre-2025 One Big Beautiful Bill Act

The most common way for an estate-taxable person or family to hold life insurance under a thorough plan was to have the policy owned under an **Irrevocable Life Insurance Trust**.

Typically, the policy on the higher earner or wealthier spouse would be owned under an **Irrevocable Life Insurance Trust,** which would benefit the surviving spouse and descendants after the death of the insured spouse.

Insured spouse would gift the premium dollars needed to keep the policy current to the trustee of the trust or would pay the premiums directly and consider that payment to be a gift to the trust.

Descendants are given a short period of time to withdraw the gifted amounts from the trust, dictated under the Crummey power rules, which allow the gifts to be considered present interest gifts to the child, therefore qualifying them for the \$19,000 annual gift exclusion.

It was common for one spouse to fund an irrevocable trust for descendants that would not benefit the other spouse because of something called the "Reciprocal Trust Doctrine."

Many couples also established "second-to-die life insurance trusts," which would purchase one or more of these policies that would pay a death benefit only after the death of the surviving spouse. These policies are less expensive than a policy on a single life, for obvious reasons.





- 1. The Super Wealthy Well Over \$15,000,000 for an Individual or \$30,000,000 for a Married Couple.
 - A. Have they been waiting to see whether they should do more (or any) estate tax planning, in hopes that the Estate Tax would be abolished? No such luck!

Get going with a plan while they are still insurable.

- B. Non-insurance related Estate Tax planning opportunities.
 - I. Annual gifting.
 - II. Making large gifts.
 - III. Qualified Personal Residence Trusts.
 - IV. Installment sales.
 - V. Life Insurance Trusts.
 - VI. Charitable Lead Annuity Trusts to zero out estate tax on death to the extent needed.
 - VII. Synergism between a CLAT to avoid estate tax and an ILIT to assure a significant benefit upon death.

Common themes:

- I. Is there enough life insurance and is it properly structured?
 - A. Add coverage and/or secure sufficient cash value.
 - 1. Consider a 1035 exchange to a more appropriate policy.
 - 2. Consider split dollar funding.





- 2. The Mid-Wealthy not well above \$15,000,000 for an individual or \$30,000,000 for a married couple, but may certainly be heading there, and what if the Estate Tax Exemption comes down in 2030 or thereafter?
 - A. What is the savings rate? - What are the prospects of growth to become super wealthy?
 - I. Review anticipated savings, rates of return on investments, and any possibly exploding assets such as a family business.
 - II. Don't forget inheritance planning--what are their parents going to leave for them? Can it be put into a Trust before they receive it?
 - III. Encourage consideration of whether the client should do extensive estate tax planning, or perhaps less estate tax planning, with one or more ILITs funded by life insurance perhaps convertible term "just in case".

Possible middle ground considerations:

- A. Keep any life insurance in place and be ready to push it into an ILIT more than three years before death. Calendar all conversion deadlines for term life policies.
- B. Is there a Buy/Sell Agreement relating to a family business or other entity that has suppressed values for estate tax purposes? Liberate the values and update buy/sell coverage.
- C. The heck with Connolly.. Increase the redemption price to take the life insurance into account so that the deceased member's family gets full monies. Perhaps an ILIT will handle any estate tax that might be owed as a result of this.
 - D. Consider re purposing ILITs and other estate tax planning Trusts. See below.





3. The No Longer Estate Taxable Family (They Hope).

Keep in mind that estate and inheritance taxes and the possible reduction of the estate tax exemption as soon as the year 2030 (where there could be a Democrat rally elect the President and regain control of the House and Senate) - stress test showing possible present arrangements to allow client to decide whether to completely disband and revamp planning structures.

- A. Are there elderly, family members or even close friends that can be given powers of appointment to increase the basis of assets on death?
- B. Does the client want to continue to pay income tax on the income of Irrevocable Grantor Trusts?
- C. Are there installment sales in place where a note is owed to the client at below market rates?

 Should the note be repaid (and if so, at a discount?).
- D. Are there homes in Qualified Personal Residence Trusts that will not get a step up or the \$250,000 for a single person/\$500,000 for a married person income tax exemption on sale after the death of the grantor.

Should another family Trust purchase the home from the QPRT and be considered as owned by the client to get an income tax step up on death and access to the \$250,000/\$500,000 exemption on sale (sometimes hard to predict what will come first).

Should the client buy life insurance from the ILIT and allow the ILIT to purchase the homestead and be restructured?

Should the life insurance that was intended to be for payment of death taxes be repurposed as savings of vehicle or should there be a 1035 exchange to a more suitable vehicle?

More to come!





**Should another Family Trust purchase the home from the QPRT and be considered as owned by the client to get an income tax step-up on death and access to the \$250,000/\$500,000 exemption on sale (sometimes hard to predict what will come first).

**Should the client buy life insurance from the ILIT, and allow the ILIT to purchase the homestead and be restructured?

**Should the life insurance that was intended to be for payment of death taxes be repurposed as savings vehicle or should there be a 1035 exchange to a more suitable vehicle?

More to come!



Comprehensive Estate Planning

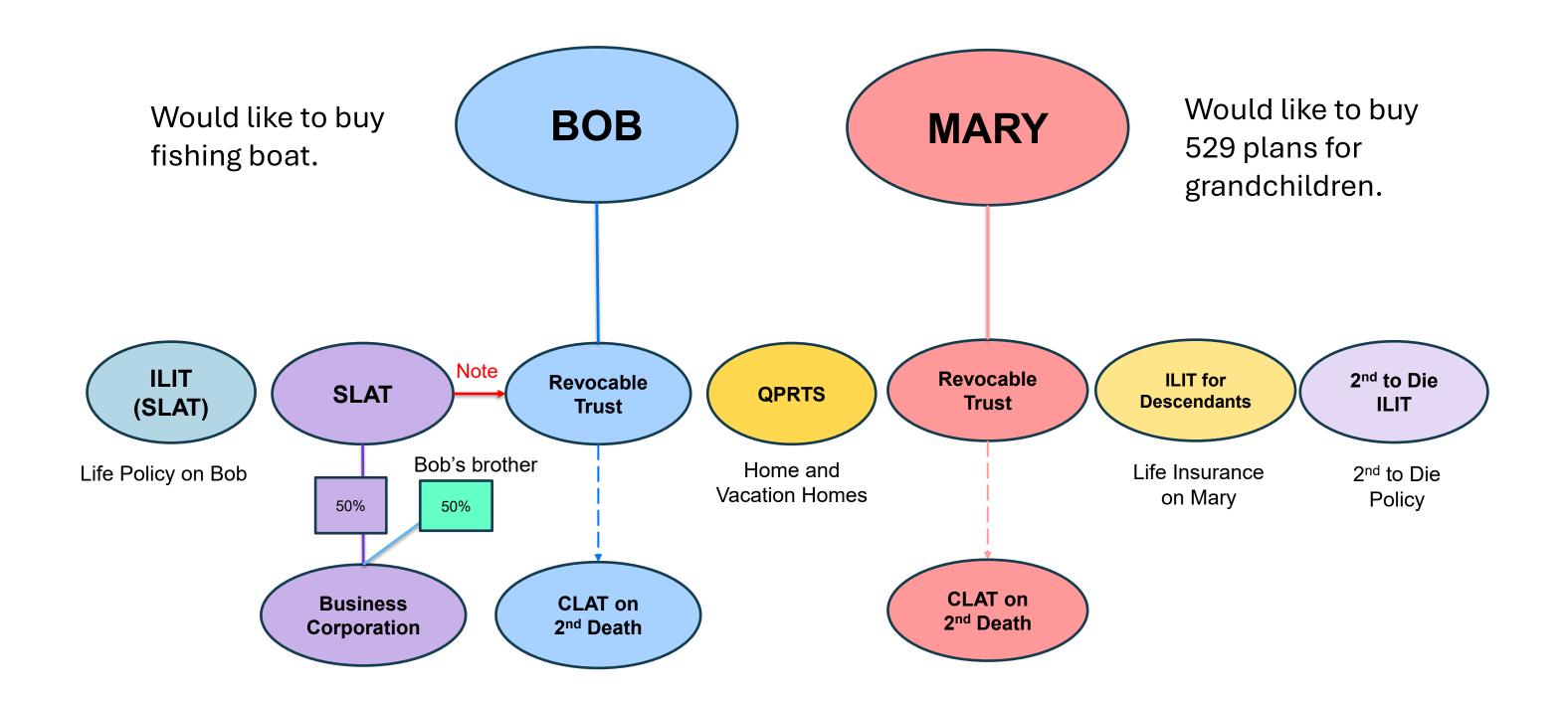
Prepared For: Bob and Mary Sample















ASSUMPTIONS

| SSUMPTIONS | | Clie | nte | | |
|---|--------|-----------------------|---------------|--------------------|--|
| 75.7 | | | nts | Nr. 0 1 | |
| Name | | Bob Sample | | Mary Sample | |
| Age | | 70 | | 64 | |
| Sex | | Male | | Female | |
| Tobacco User | | No | | No | |
| Lifetime Gift Exclu Used | | \$o | | \$o | |
| Projected Year of I | | 2035 | | 2045 | |
| Net Annual Savings, | /Outgo | \$250,000 per | year | \$300,000 per year | |
| Savings Transition | ı Age | 78 | | 78 | |
| Rest of Life | | \$100,000 per | year | \$100,000 per year | |
| | | Portal | oility | | |
| Assume no portab | ility? | No | | | |
| | | Exemption A | Adjustment | | |
| Exemption Adjust Option: | ment | CPI adjustmen | | | |
| | | Business and | Investments | 6 | |
| Current Value | | \$30,500,000 | | | |
| Annual Growth F | Rate | 7.50% | | | |
| Annual Investment | | 0.40% | | | |
| Rate | | 2.00% | | | |
| Annual Investment Tax | | 2.00% | | | |
| Rate (as % of ass | | sonal Residen | on and Prop | ortu | |
| Current Value | | | ce and Frop | erty | |
| Annual Growth F | | \$3,000,000 | | | |
| Allitual Glowth F | tate | 3.75% | Tomot | | |
| D T 17- | 1 | Bypass | Trust | | |
| Bypass Trust Va | rue | \$20,800,000 | | | |
| T 1/1 1 0/01 PR | 77.1 | Gifti | ing | | |
| Initial Gifting Trust | | \$o | | | |
| Exempt Gifts per | | 2 Donees | | | |
| Number of Yea | | 10 | | | |
| Subsequent Gifts pe | | 6 Donees | | | |
| Percentage of Gifts to Gifting Trust | | 100.00% | | | |
| | Li | <u>fe Insurance -</u> | - Pre-planniı | | |
| Insured | Bob S | ample | Mary Sample | Second To Die | |
| | | Polic | y 1 | | |
| Held in ILIT? | No | | No | No | |
| Policy Type | Perma | nent | Permanent | Permanent | |
| Number of Years | 35 | | 35 | 35 | |
| Annual Premium | \$58,0 | 00 | \$19,000 | \$104,000 | |
| Number of Additional Years | 15 | | 0 | 0 | |
| Additional Years | | | | | |





| Additional Years Annual Premium | \$58,000 | \$19,000 | \$o | | |
|--------------------------------------|----------------|-----------------|---------------|--|--|
| Initial Death Benefit | \$2,000,000 | \$2,000,000 | \$8,000,000 | | |
| Death Benefit Term | 35 | 35 | 35 | | |
| Subsequent Death Benefit | \$2,000,000 | \$2,000,000 | \$8,000,000 | | |
| | Life Insurance | - Post-planning | | | |
| Insured | Bob Sample | Mary Sample | Second To Die | | |
| Policy 1 | | | | | |
| Held in ILIT? | Yes | Yes | Yes | | |
| Policy Type | Permanent | Permanent | Permanent | | |
| Number of Years | 35 | 35 | 35 | | |
| Annual Premium | \$58,000 | \$19,000 | \$104,000 | | |
| Number of Additional Years | 15 | 0 | o | | |
| Additional Years Annual Premium | \$58,000 | \$19,000 | \$o | | |
| Initial Death Benefit | \$2,000,000 | \$2,000,000 | \$8,000,000 | | |
| Death Benefit Term | 35 | 35 | 35 | | |
| Subsequent Death Benefit | \$2,000,000 | \$2,000,000 | \$8,000,000 | | |
| | Large Gi | ft To Trust | | | |
| Value Gifted | \$5,000,000 | | | | |
| Large Gift Discount Rate | 0.00% | | | | |
| Large Gift Value After Discount | \$5,000,000 | | | | |
| Split Large Gift | No | | | | |
| Year to Toggle Off Grantor Status | Never | | | | |
| | R | ates | | | |
| Consumer Price Index Growth Rate | 3.71% | | | | |
| Real Inflation | 4.01% | | | | |
| Estate Tax Rate | 40.00% | | | | |
| Adjust for Real Inflation | No | | | | |
| Charity | | | | | |
| Charity, CLAT, or CRT? | CLAT | | | | |
| Charity Name | | | | | |
| Percent of Residue to CLAT | 100.00% | | | | |
| Percent of CLAT to Charity | 50.00% | | | | |
| Number of Years | 20 | | | | |

EstateView InstantPlan Comprehensive Planning Strategies Continued





ILLUSTRATION - DIES IN 2026 (NO PLANNING) Both spouses die in one year

| | | | both speases are in | one year | | |
|----------------|--------------------|---|--|----------------|--|-----------------------|
| Today | 1 | Bob & Mary Samp | le | Life Ins Bob | Life Ins Mary | Life Ins Survivorship |
| | Residence | Investments | | Death Benefit | Death Benefit | Death Benefit |
| | \$3,000,000 | \$30,500,000 | | \$2,000,000 | \$2,000,000 | \$8,000,000 |
| | Annual Growth Rate | Annual Additions | Annual Growth Rate | Annual Premium | Annual Premium | Annual Premium |
| | 3.75% | \$250,000 | 7.50% less 0.40% fees | \$58,000 | \$19,000 | \$104,000 |
| | | | and 2.00% tax | П | П | П |
| | | Î | | ↑ ↑ | | ↑ |
| Upon 1st Death | | Bob Sample | | Life Ins Bob | Life Ins Mary | Life Ins Survivorship |
| (in Year 1) | Residence | Investments | | Death Benefit | Death Benefit | Death Benefit |
| | \$3,112,500 | \$31,874,500 | | \$2,000,000 | \$2,000,000 | \$8,000,000 |
| | Annual Growth Rate | Annual Additions | Annual Growth Rate | Annual Premium | Annual Growth Rate | Annual Premium |
| | 3.75% | \$0 | 7.50% less 0.40% fees and 2.00% tax | \$58,000 | 7.50% less 0.40% fees | \$104,000 |
| | | Î | | 4 | 4 | 4 |
| Upon 2nd Death | Beridense | Bob's Estate | | Life Ins Bob | Life Ins Mary | Life Ins Survivorship |
| (in Year 1) | Residence | Investments | | Value | Value | Value |
| | \$3,112,500 | \$31,874,500 | 2 000 000 | \$2,000,000 | \$2,000,000 | \$8,000,000 |
| | | tion/Portability: (\$30 axable Estate: \$16, | | | | |
| | Net is | J. | \$ | ☆ | 1 | ↑ |
| | | Estate Tax \$6,794,800 | | | Total Passed to Beneficiaries \$40,192,200 | |





ILLUSTRATION - DIES IN 2026 (WITH PLANNING)

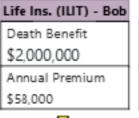
Both spouses die in one year

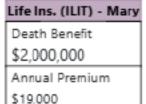


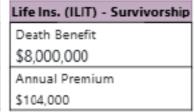
| | Bob & Mary Sample | | | | | | |
|--------------------|----------------------------|--------------------|--|--|--|--|--|
| Residence | Investments | | | | | | |
| \$3,000,000 | \$25,500,000 | \$25,500,000 | | | | | |
| Annual Growth Rate | Annual Additions | Annual Growth Rate | | | | | |
| 3.75% | \$250,000 7.50% less 0.40% | | | | | | |
| | | and 2.00% tax | | | | | |















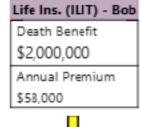


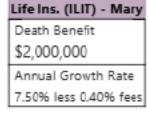
Upon 1st Death (in Year 1)

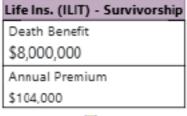
| Bob Sample | | | | | |
|--------------------|------------------|-----------------------|--|--|--|
| Residence | Investments | | | | |
| \$3,112,500 | \$16,119,500 | | | | |
| Annual Growth Rate | Annual Additions | Annual Growth Rate | | | |
| 3.75% | \$0 | 7.50% less 0.40% fees | | | |
| | | and 2.00% tax | | | |

















Upon 2nd Death (in Year 1)

> Amount to CLAT \$4,632,000 (100%)

Amount to Bob and Mary

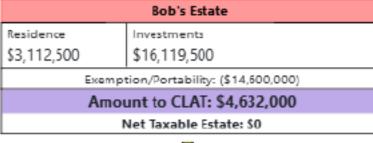
Sample Foundation

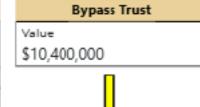
\$2,316,000 (50%)

Remainder to Beneficiaries

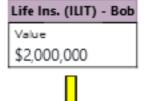
\$2,316,000 (50%)

(in year 20)

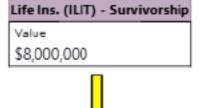


























Total Passed to Beneficiaries \$42,355,000 +

\$2,316,000 -\$44,671,000

Amount Sacrificed by Beneficiaries to Facilitate Charitable: \$463,200

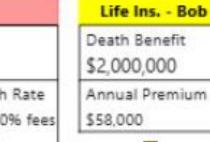




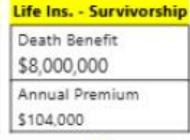
ILLUSTRATION 1 - NO PLANNING (20 YEARS)

| Bob & Mary Sample | | | | | |
|-----------------------------|-------------------------------|--|--|--|--|
| Residence \$3,000,000 | Investments \$30,500,000 | | | | |
| Annual Growth Rate 3.75% | Annual Additions \$250,000 | Annual Growth Rate 7.50% less 0.40% fees and 2.00% tax | | | |





Life Ins. - Mary Death Benefit \$2,000,000 Annual Premium \$19,000





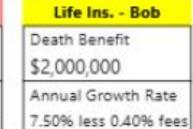


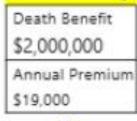


Upon 1st Death (in Year 10)

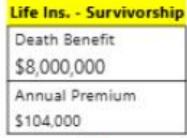
| | Mary Sample | |
|-----------------------------|-------------------------------|--|
| Residence \$4,335,132 | Investments \$51,240,434 | |
| Annual Growth Rate 3.75% | Annual Additions \$444,500 | Annual Growth Rate 7.50% less 0.40% fees and 2.00% tax |







Life Ins. - Mary









- Survivorship

Upon 2nd Death (in Year 20)

| | Mary's Estate | Life Ins Bob | Life Ins Mary | Life Ins Sur |
|--------------------------|------------------------------------|----------------------|----------------------------------|----------------------|
| Residence | Investments | Value \$3,300,040 | Value | Value \$0,000,000 |
| \$6,264,456 \$86,087,896 | | \$3,288,949 | \$2,000,000 | \$8,000,000 |
| | mption/Portability: (\$40,360,000) | | П | П |
| N- | et Taxable Estate: \$65,281,301 | | 100 Day 100 | |
| | | Y | • | • |
| | | <u> </u> | | |
| | Estate Tax | | Total Passed to Beneficiaries | |





(FUNDED YEAR 10)

| | | | ILLUS |
|----------------|--------------------|------------------|-----------------------|
| | | | |
| Today | ı | Bob & Mary Samp | le |
| | Residence | Investments | |
| | \$3,000,000 | \$30,500,000 | |
| | Annual Growth Rate | Annual Additions | Annual Growth Rate |
| | 3.75% | \$250,000 | 7.50% less 0.40% fees |
| | | | and 2.00% tax |
| | | 1 | |
| Upon 1st Death | | Mary Sample | |
| (in Year 10) | Residence | Investments | |
| | \$4,335,132 | \$40,840,434 | |
| | Annual Growth Rate | Annual Additions | Annual Growth Rate |
| | 3.75% | \$444,500 | 7.50% less 0.40% fees |
| | | | and 2.00% tax |
| | | $\frac{1}{1}$ | |
| | | | |

Mary's Estate

Exemption/Portability: (\$29,960,000)

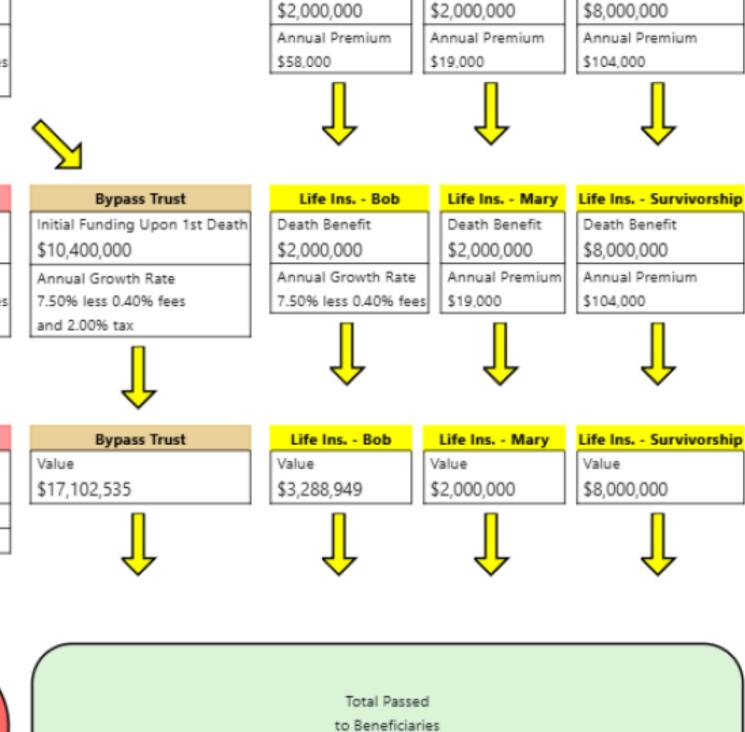
Net Taxable Estate: \$58,578,765

Estate Tax

\$23,431,506

Investments

\$68,985,360



\$82,209,795

Life Ins. - Bob

Death Benefit

Life Ins. - Mary

Death Benefit

Life Ins. - Survivorship

Death Benefit





Upon 2nd Death

(in Year 20)

Residence

\$6,264,456

ILLUSTRATION 3 - ANNUAL GIFTING (2 DONEES)

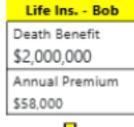
Today

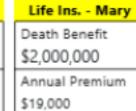
| | Bob & Mary Sample | | | | | |
|--------------------|----------------------------------|-----------------------|--|--|--|--|
| Residence | e Investments | | | | | |
| \$3,000,000 | \$30,500,000 | | | | | |
| Annual Growth Rate | Annual Additions Annual Growth F | | | | | |
| 3.75% | \$250,000 | 7.50% less 0.40% fees | | | | |
| | | and 2.00% tax | | | | |



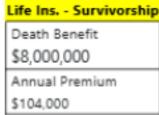


Gifting Trust(s) Value \$0 Annual Gifts \$76,000 Annual Growth Rate 7.50% less 0.40% fees











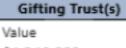


| Mary Sample | | | | | |
|--------------------|------------------|-----------------------|--|--|--|
| Residence | ence Investments | | | | |
| \$4,335,132 | \$39,591,511 | | | | |
| Annual Growth Rate | Annual Additions | Annual Growth Rate | | | |
| 3.75% | \$444,500 | 7.50% less 0.40% fees | | | |
| | | and 2.00% tax | | | |









\$1,248,923 Annual Gifts \$162,000 Annual Growth Rate 7.50% less 0.40% fees



Life Ins. - Bob

Death Benefit \$2,000,000 Annual Growth Rate 7.50% less 0.40% fees \$19,000



Life Ins. - Survivorship

Death Benefit \$8,000,000 Annual Premium \$104,000



Life Ins. - Mary

Death Benefit

\$2,000,000

Annual Premium



Upon 2nd Death (in Year 20)

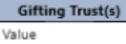
| Mary's Estate | | | | |
|-----------------------|---------------------------------------|--------------|--|--|
| Residence Investments | | | | |
| | \$6,264,456 | \$64,237,760 | | |
| | Exemption/Portability: (\$29,960,000) | | | |
| | Net Taxable Estate: \$53,831,165 | | | |
| | | | | |













Life Ins. - Bob

Value \$3,288,949





Life Ins. - Mary

Value \$2,000,000





Value \$8,000,000



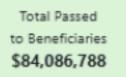






ILLUSTRATION 4 - LIFE INSURANCE TRUST PLANNING (20 YEARS)



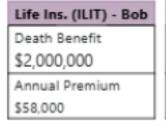
| Bob & Mary Sample | | | |
|--------------------|------------------|-----------------------|--|
| Residence | Investments | | |
| \$3,000,000 | \$30,500,000 | | |
| Annual Growth Rate | Annual Additions | Annual Growth Rate | |
| 3.75% | \$250,000 | 7.50% less 0.40% fees | |
| | | and 2.00% tax | |

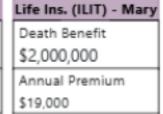


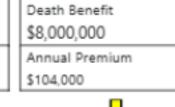


Gifting Trust(s) Value \$0 Annual Gifts \$76,000 Annual Growth Rate 7.50% less 0.40% fees

Gifting Trust(s)











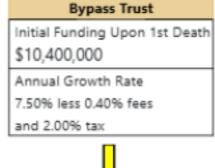


Life Ins. (ILIT) - Survivorship

Upon 1st Death (in Year 10)

| Mary Sample | | | | |
|--------------------------|------------------|-----------------------|--|--|
| Residence Investments | | | | |
| \$4,335,132 \$40,840,434 | | | | |
| Annual Growth Rate | Annual Additions | Annual Growth Rate | | |
| 3.75% | \$444,500 | 7.50% less 0.40% fees | | |
| | | and 2.00% tax | | |

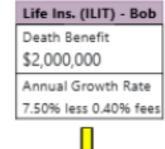




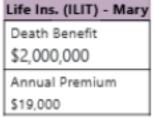


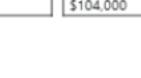
Value

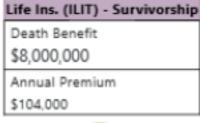
\$0











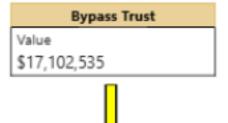


Upon 2nd Death (in Year 20)

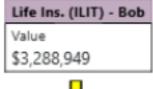
| Residence Investments \$6,264,456 \$68,123,688 Exemption/Portability: (\$29,960 | Mary's Estate | | |
|---|---------------|--|--|
| | | | |
| Net Taxable Estate: \$44.428 | | | |
| Net Taxable Estate: \$44,428,144 | | | |











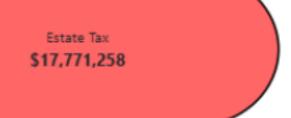












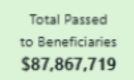






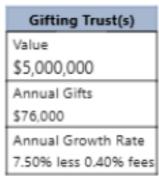
ILLUSTRATION 5 - LARGE GIFT (20 YEARS)

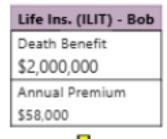
Today

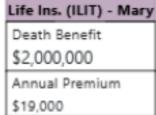
| Bob & Mary Sample | | | | |
|--------------------------|------------------|-----------------------|--|--|
| Residence Investments | | | | |
| \$3,000,000 \$25,500,000 | | | | |
| Annual Growth Rate | Annual Additions | Annual Growth Rate | | |
| 3.75% | \$250,000 | 7.50% less 0.40% fees | | |
| | | and 2.00% tax | | |
| | | | | |













Life Ins. (ILIT) - Survivorship Death Benefit \$8,000,000 Annual Premium \$104,000



Upon 1st Death (in Year 10)

| Mary Sample | | | | |
|--------------------------|------------------|-----------------------|--|--|
| Residence Investments | | | | |
| \$4,335,132 \$35,912,367 | | | | |
| Annual Growth Rate | Annual Additions | Annual Growth Rate | | |
| 3.75% | \$444,500 | 7.50% less 0.40% fees | | |
| | | and 2.00% tax | | |









Gifting Trust(s)

Value

\$18,687,707



Life Ins. (ILIT) - Bob Life Ins. (ILIT) - Mary Death Benefit \$2,000,000 Annual Premium 7.50% less 0.40% fees \$19,000



Life Ins. (ILIT) - Survivorship Death Benefit \$8,000,000 Annual Premium \$104,000

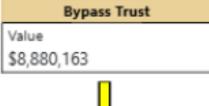


Upon 2nd Death (in Year 20)

| Mary's Estate | | | | |
|---------------------------------------|--------------|--------------|--|--|
| Residence Investments | | | | |
| \$6,264,456 | \$58,402,917 | \$58,402,917 | | |
| Exemption/Portability: (\$29,960,000) | | | | |
| Net Taxable Estate: \$34,707,373 | | | | |
| | П | \ | | |









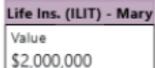


Death Benefit

\$2,000,000

Annual Growth Rate







Life Ins. (ILIT) - Survivorship Value \$8,000,000



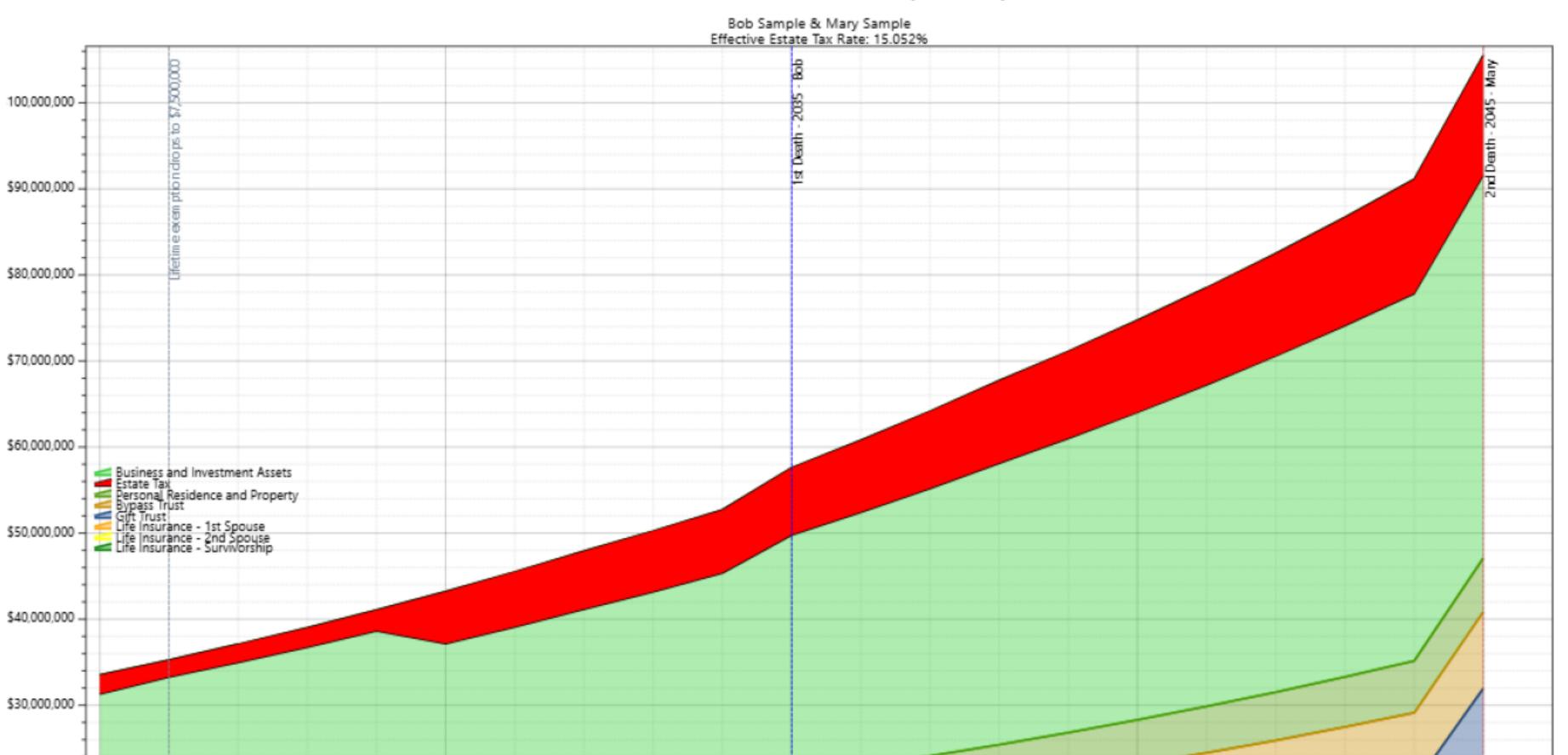


Total Passed to Beneficiaries \$91,641,242





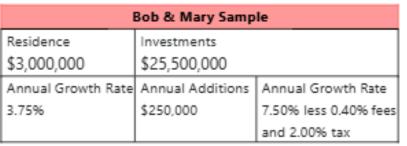
ILLUSTRATION 5 - LARGE GIFT (20 YEARS)







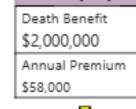
Today

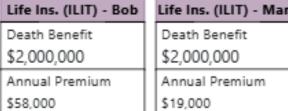


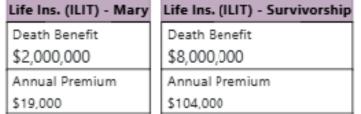




Gifting Trust(s) \$5,000,000 Annual Gifts \$76,000 Annual Growth Rate 7.50% less 0.40% fees











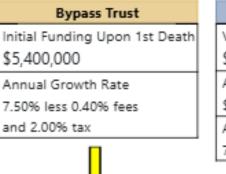


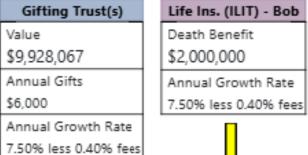
Upon 1st Death (in Year 10)

| Mary Sample | | | | |
|--------------------|------------------|-----------------------|--|--|
| Residence | Investments | | | |
| \$4,335,132 | \$35,912,367 | | | |
| Annual Growth Rate | Annual Additions | Annual Growth Rate | | |
| 3.75% | \$444,500 | 7.50% less 0.40% fees | | |
| | | and 2.00% tax | | |



\$5,400,000







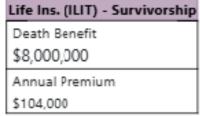
Annual Growth Rate

Death Benefit

\$2,000,000

Life Ins. (ILIT) - Mary Death Benefit \$2,000,000 Annual Premium \$19,000







Upon 2nd Death (in Year 20)

> Amount to CLAT \$34,707,373 (100%)

Amount to Bob and Mary

Sample Foundation

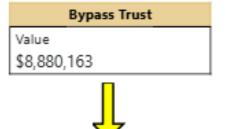
\$17,353,687 (50%)

Remainder to Beneficiaries \$17,353,687 (50%)

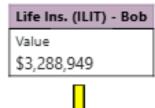
(in year 20)

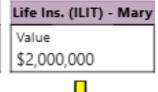
| Mary's Estate | | | |
|---------------------------------------|-------------|--|--|
| Residence | Investments | | |
| \$6,264,456 \$58,402,917 | | | |
| Exemption/Portability: (\$29,960,000) | | | |
| Amount to CLAT: \$34,707,373 | | | |
| Net Taxable Estate: \$0 | | | |

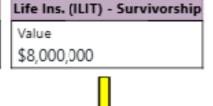






















Total Passed to Beneficiaries \$70,816,819 +

\$17,353,687 = \$88,170,505

Amount Sacrificed by Beneficiaries to Facilitate Charitable: \$3,470,737

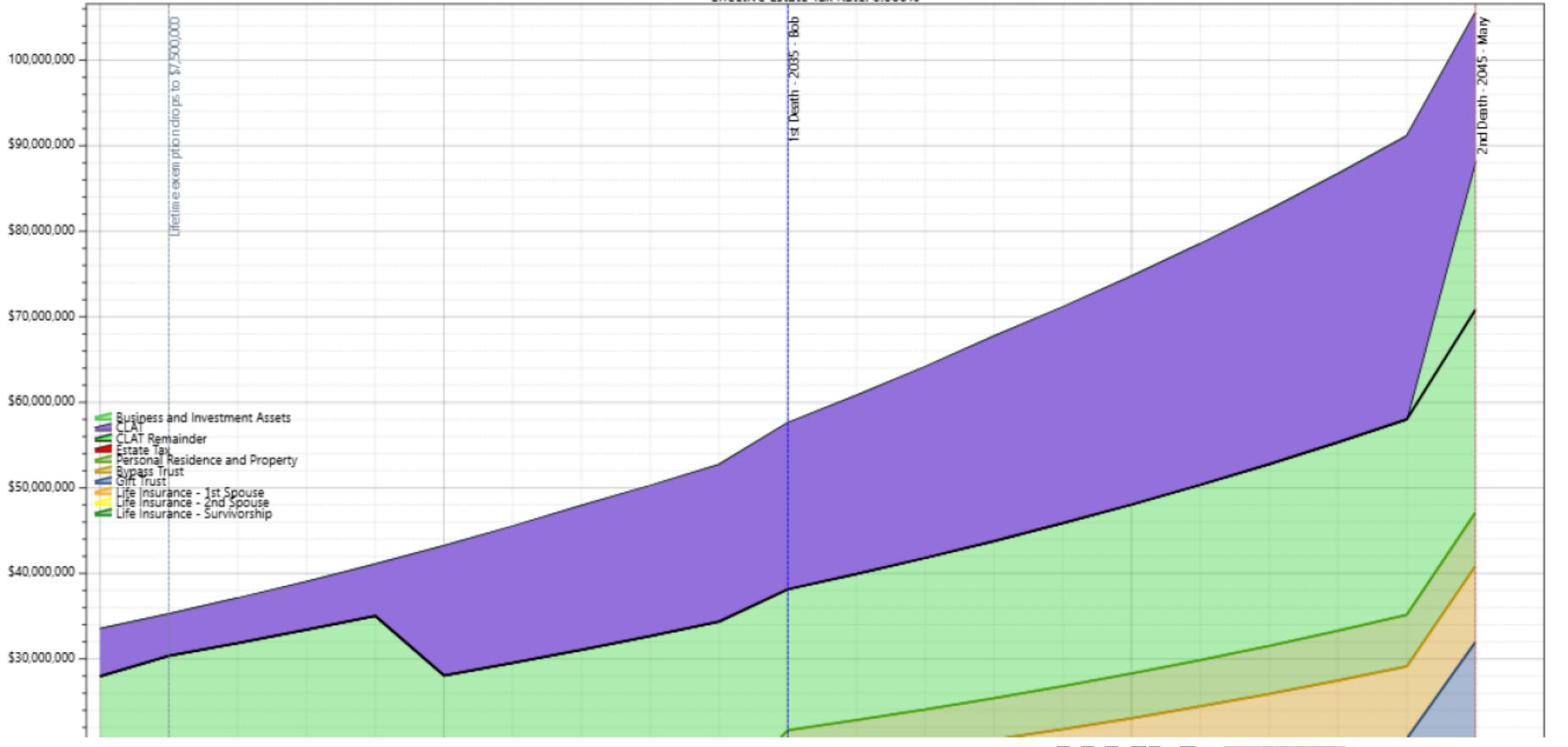






ILLUSTRATION 6 - TESTAMENTARY CHARITY

Bob Sample & Mary Sample Effective Estate Tax Rate: 0.000%







WHAT IF THE EXEMPTION GOES DOWN BY ONE-HALF IN 2030?



ILLUSTRATION 1 - NO PLANNING (20 YEARS)

| Tions: | | Personal Co. |
|--------|---|--------------|
| | а | JUL 14 |

| Bob & Mary Sample | | | | |
|--------------------|---|-----------------------|--|--|
| Residence | Investments | | | |
| \$3,000,000 | \$30,500,000 | | | |
| Annual Growth Rate | e Annual Additions Annual Growth Rate | | | |
| 3.75% | \$250,000 | 7.50% less 0.40% fees | | |
| | | and 2.00% tax | | |



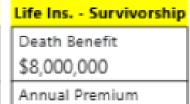
Life Ins. - Bob Death Benefit

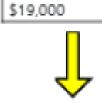
Annual Premium

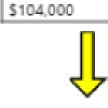
\$2,000,000

\$58,000

Life Ins. - Mary Death Benefit \$2,000,000 Annual Premium





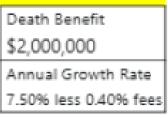


Life Ins. - Survivorship

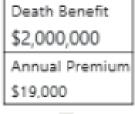
Upon 1st Death (in Year 10)

| Mary Sample | | | | |
|--------------------|-------------------------------------|-----------------------|--|--|
| Residence | Investments | | | |
| \$4,335,132 | \$51,240,434 | | | |
| Annual Growth Rate | Annual Additions Annual Growth Rate | | | |
| 3.75% | \$444,500 | 7.50% less 0.40% fees | | |
| | | and 2.00% tax | | |

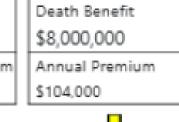




Life Ins. - Bob



Life Ins. - Mary









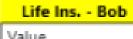
Life Ins. - Survivorship

Upon 2nd Death (in Year 20)

| | Mary's Estate | |
|---------------------------------------|---------------|--|
| Residence | Investments | |
| \$6,264,456 \$86,087,896 | | |
| Exemption/Portability: (\$40,360,000) | | |
| Net Taxable Estate: \$65,281,301 | | |
| Į. S | | |







Value \$3,288,949





Value \$2,000,000





Value

Total Passed to Beneficiaries \$79,528,780





ILLUSTRATION 2 - BYPASS TRUST (FUNDED YEAR 10)

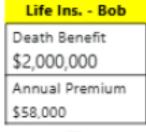
Today

| Bob & Mary Sample | | | |
|--------------------|-------------------------------------|---------------|--|
| Residence | Investments | | |
| \$3,000,000 | \$30,500,000 | | |
| Annual Growth Rate | Annual Additions Annual Growth Rate | | |
| 3.75% | \$250,000 7.50% less 0.40% fo | | |
| | | and 2.00% tax | |

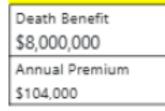








Life Ins. - Mary Death Benefit \$2,000,000 Annual Premium \$19,000



Life Ins. - Survivorship







Life Ins. - Survivorship

Death Benefit

Upon 1st Death (in Year 10)

Upon 2nd Death

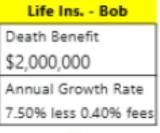
(in Year 20)

| Mary Sample | | | | |
|--------------------|----------------------------|--------------------|--|--|
| Residence | Investments | | | |
| \$4,335,132 | \$40,840,434 | | | |
| Annual Growth Rate | Annual Additions | Annual Growth Rate | | |
| 3.75% | \$444,500 7.50% less 0.40% | | | |
| | | and 2.00% tax | | |





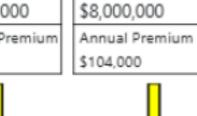






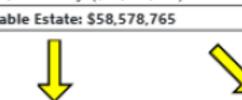
Life Ins. - Mary

Life Ins. - Mary

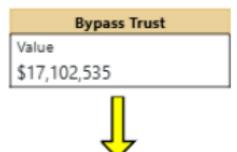


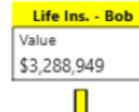


| Mary's Estate | | | |
|---------------------------------------|--------------|--|--|
| Residence Investments | | | |
| \$6,264,456 | \$68,985,360 | | |
| Exemption/Portability: (\$29,960,000) | | | |
| Net Taxable Estate: \$58,578,765 | | | |
| | | | |



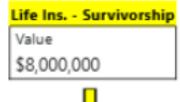








Value





Total Passed to Beneficiaries \$82,209,795





ILLUSTRATION 3 - ANNUAL GIFTING (2 DONEES)

| T | `~ | a | - | | , | |
|---|----|---|---|---|----|--|
| 1 | u | u | а | n | F. | |

| Bob & Mary Sample | | | | |
|--------------------|-------------------------------------|---------------|--|--|
| Residence | Investments | | | |
| \$3,000,000 | \$30,500,000 | | | |
| Annual Growth Rate | Annual Additions Annual Growth Rate | | | |
| 3.75% | \$250,000 7.50% less 0.40% f | | | |
| | | and 2.00% tax | | |

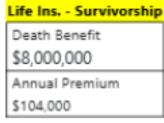












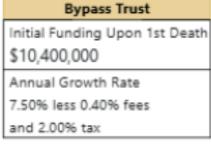




| Mary Sample | | | |
|--------------------|------------------|-----------------------|--|
| Residence | Investments | | |
| \$4,335,132 | \$39,591,511 | | |
| Annual Growth Rate | Annual Additions | Annual Growth Rate | |
| 3.75% | \$444,500 | 7.50% less 0.40% fees | |
| | | and 2.00% tax | |



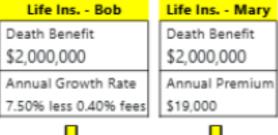
Mary's Estate













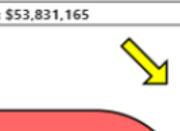
Life Ins. - Survivorship Death Benefit \$8,000,000 Annual Premium \$104,000



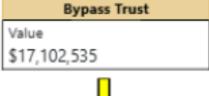
Upon 2nd Death (in Year 20)

| | mary 5 cotate | |
|-------------|-----------------------------------|------------|
| Residence | Investments | |
| \$6,264,456 | \$64,237,760 | |
| Exem | ption/Portability: (\$29,960,000) | |
| Net | Taxable Estate: \$53,831,165 | |
| | Ţ | \searrow |
| | | |





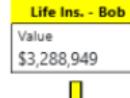




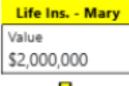




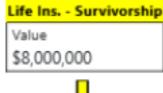














Total Passed to Beneficiaries \$84,086,788





ILLUSTRATION 4 - LIFE INSURANCE TRUST PLANNING (20 YEARS)

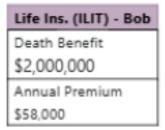
Today

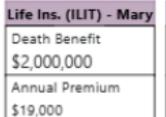
| Bob & Mary Sample | | | |
|--------------------|---------------------|-----------------------|--|
| Residence | sidence Investments | | |
| \$3,000,000 | \$30,500,000 | | |
| Annual Growth Rate | Annual Additions | Annual Growth Rate | |
| 3.75% | \$250,000 | 7.50% less 0.40% fees | |
| and 2.00% tax | | | |
| _ | | | |

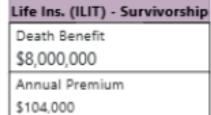




Value \$0 Annual Gifts \$76,000 Annual Growth Rate 7.50% less 0.40% fees











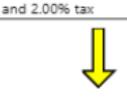


Upon 1st Death (in Year 10)

| Mary Sample | | | |
|--------------------|------------------|-----------------------|--|
| Residence | Investments | | |
| \$4,335,132 | \$40,840,434 | | |
| Annual Growth Rate | Annual Additions | Annual Growth Rate | |
| 3.75% | \$444,500 | 7.50% less 0.40% fees | |
| | | and 2.00% tax | |

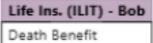






Value \$0 Annual Gifts \$6,000 Annual Growth Rate





\$2,000,000 Annual Growth Rate 7.50% less 0.40% fees



Death Benefit

\$2,000,000 Annual Premium \$19,000



Life Ins. (ILIT) - Survivorship

Death Benefit

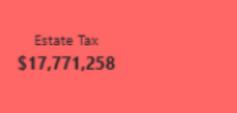
\$8,000,000 Annual Premium \$104,000

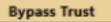


Upon 2nd Death (in Year 20)

| | Mary's Estate | |
|-----------------------|------------------------------|--------|
| Residence Investments | | |
| \$6,264,456 | \$68,123,688 | |
| Exer | nption/Portability: (\$29,96 | 0,000) |
| Ne | t Taxable Estate: \$44,428 | 3,144 |
| | П | ^ |







Value \$17,102,535



Gifting Trust(s)

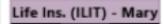
Value \$859,348



Life Ins. (ILIT) - Bob

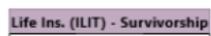
Value \$3,288,949





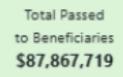
Value \$2,000,000





Value \$8,000,000











Today

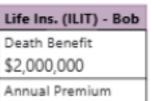
| Bob & Mary Sample | | | |
|--------------------|-------------------------------------|---------------|--|
| Residence | Investments | | |
| \$3,000,000 | \$25,500,000 | | |
| Annual Growth Rate | Annual Additions Annual Growth Rate | | |
| 3.75% | \$250,000 7.50% less 0.40% fo | | |
| | | and 2.00% tax | |



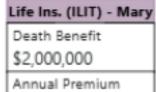


Value \$5,000,000 Annual Gifts \$76,000

Annual Growth Rate 7.50% less 0.40% fees



\$58,000





Life Ins. (ILIT) - Survivorship

Death Benefit
\$8,000,000

Annual Premium
\$104,000



Upon 1st Death (in Year 10)

| Mary Sample | | | |
|--------------------|------------------|-----------------------|--|
| Residence | Investments | | |
| \$4,335,132 | \$35,912,367 | | |
| Annual Growth Rate | Annual Additions | Annual Growth Rate | |
| 3.75% | \$444,500 | 7.50% less 0.40% fees | |
| | | and 2.00% tax | |



Bypass Trust
Initial Funding Upon 1st Death
\$5,400,000

Rate
Annual Growth Rate
7.50% less 0.40% fees
and 2.00% tax



Value \$9,928,067 Annual Gifts \$6,000 Annual Growth Rate



Death Benefit \$2,000,000

Annual Growth Rate 7.50% less 0.40% fees



Death Benefit \$2,000,000

Annual Premium \$19,000



Life Ins. (ILIT) - Survivorship

\$8,000,000 Annual Premium

\$104,000



Upon 2nd Death (in Year 20)

| Mary's Estate | | |
|---------------|------------------------------------|--|
| Residence | Investments | |
| \$6,264,456 | \$58,402,917 | |
| Exem | nption/Portability: (\$29,960,000) | |
| Net | Taxable Estate: \$34,707,373 | |
| | | |





Value \$8,880,163

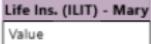


Value

Gifting Trust(s)













Life Ins. (ILIT) - Survivorship

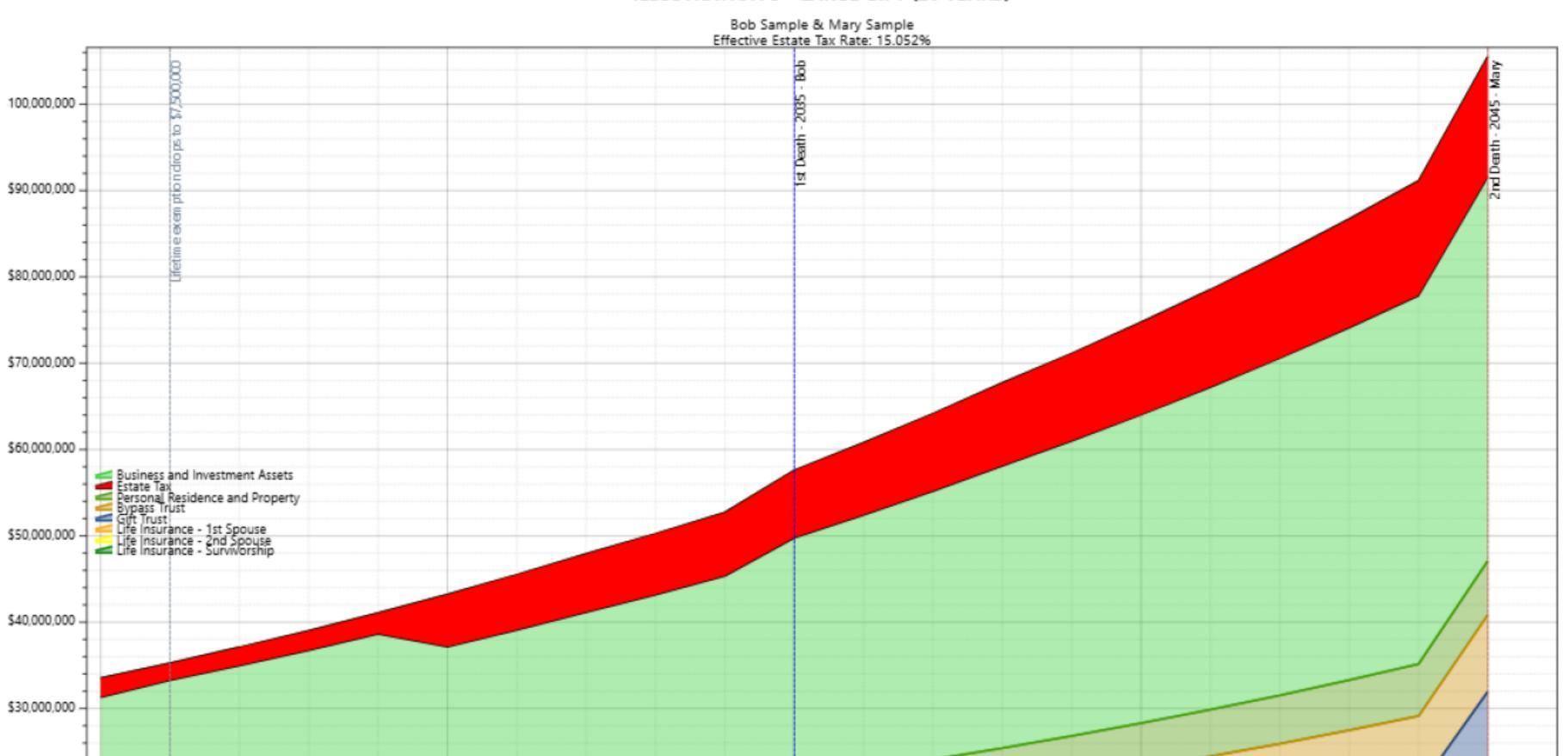


Total Passed to Beneficiaries \$91,641,242





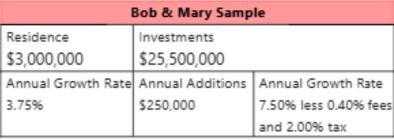
ILLUSTRATION 5 - LARGE GIFT (20 YEARS)







Today







Gifting Trust(s) Value \$5,000,000 Annual Gifts \$76,000 Annual Growth Rate 7.50% less 0.40% fees



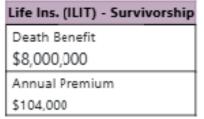
Death Benefit

\$2.000,000

Life Ins. (ILIT) - Bob

Life Ins. (ILIT) - Mary Death Benefit \$2.000,000 Annual Premium \$19,000

Life Ins. (ILIT) - Mary

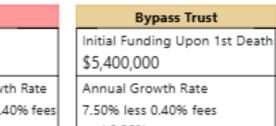


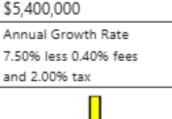


Upon 1st Death (in Year 10)

| Mary Sample | | | |
|--------------------|------------------|-----------------------|--|
| Residence | Investments | | |
| \$4,335,132 | \$35,912,367 | | |
| Annual Growth Rate | Annual Additions | Annual Growth Rate | |
| 3.75% | \$444,500 | 7.50% less 0.40% fees | |
| | | and 2.00% tax | |





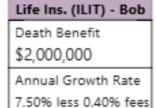


Bypass Trust











Death Benefit

\$2,000,000

Life Ins. (ILIT) - Survivorship Death Benefit \$8,000,000 Annual Premium \$104,000



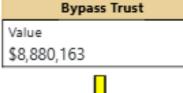
Upon 2nd Death (in Year 20)

| Mary's Estate | | |
|---------------------------------------|--------------|--|
| Residence | Investments | |
| \$6,264,456 | \$58,402,917 | |
| Exemption/Portability: (\$29,960,000) | | |
| Amount to CLAT: \$34,707,373 | | |
| Net Taxable Estate: \$0 | | |
| _ | | |



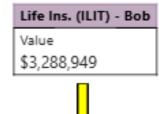


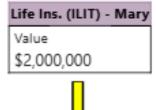


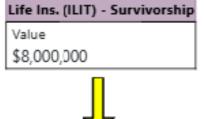














Amount to CLAT \$34,707,373 (100%)

Amount to Bob and Mary Sample Foundation \$17,353,687 (50%)

Remainder to Beneficiaries \$17,353,687 (50%) (in year 20)



Total Passed to Beneficiaries

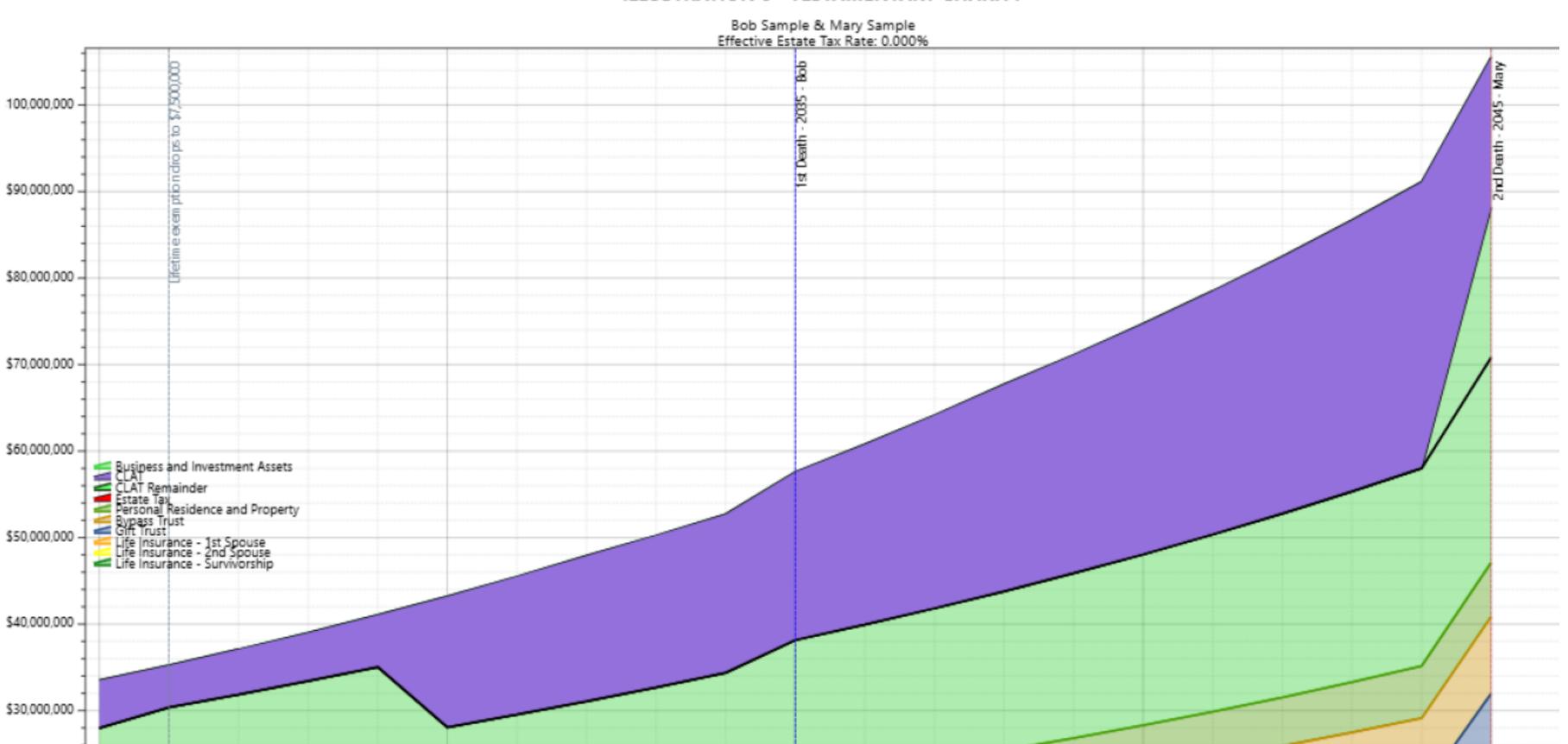
\$70,816,819 + \$17,353,687 = \$88,170,505

Amount Sacrificed by Beneficiaries to Facilitate Charitable: \$3,470,737





ILLUSTRATION 6 - TESTAMENTARY CHARITY

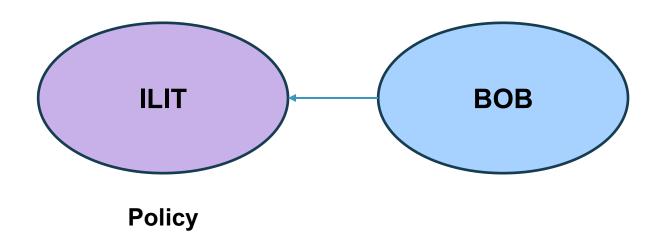






BOB AND HIS ILIT

Keep Policy in ILIT



- 1. Status Quo Keep gifting premiums.
- 2. Reduce Death Benefit Stop gifting.
- 3. Loan instead of Gift at Arm's-Length (8% interest?)
- 4. Use Split Dollar Loan or Economic Benefit Regime
 - Smaller gifts.
- 5. Consider Premium Financing.

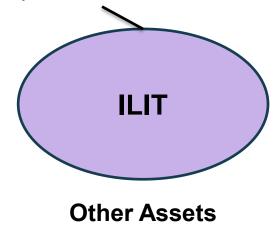


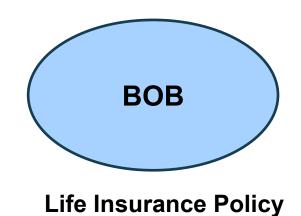


BOB AND HIS ILIT (HELD FOR MARY AND DESCENDANTS

Buy Policy from ILIT

Give Power of Appointment to older relatives to obtain step-up on death.





- 1. Buy policy and fatten it up Maybe to MEC
- 2. Buy policy out and convert to a better vehicle
 - A. With long-term care
 - B. PPLI [?]
 - C. Variable contract [?]
 - D. Equity index [?]
 - E. Possible premium financing [?]

ILIT may buy 529 Plan Accounts:

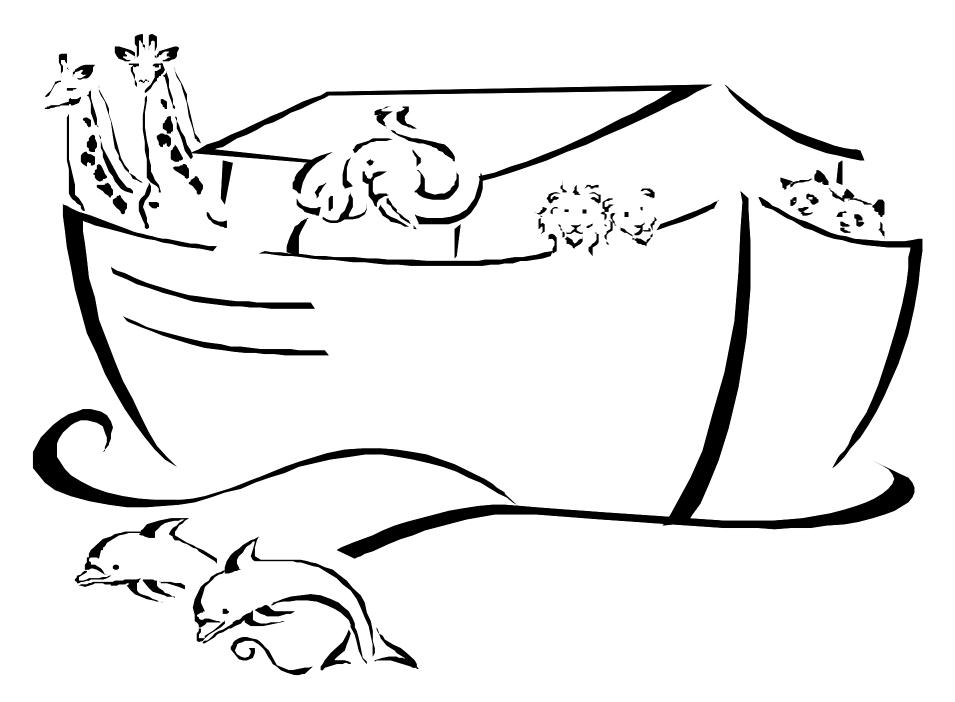
ILIT may become Non-Grantor Trust

- A. Sprinkle income to lower bracket beneficiaries
- B. Pay property taxes
- C. Pay income to charity





"It Wasn't Raining When Noah Built The Ark."







Giacalone v. Medic West Ambulance Inc.

Actress' family awarded \$29.5M
 after allergic reaction to peanut
 butter pretzel caused brain damage

LAS VEGAS - The family of an aspiring actress and model who was left braindamaged after suffering a serious allergic reaction to a pretzel infused with peanut butter was awarded nearly \$30 million by a Las Vegas jury.

On Feb. 20, 2013, then-27-year-old Chantel Giacalone went into anaphylactic shock after biting into the peanut butter pretzel while modeling clothes at a fashion trade show at the Mandalay Bay South Convention Center, the Las Vegas Review-Journal reported.

The paper reported that Giacalone's friend brought her a frozen yogurt and put the bite-sized pretzel on top. Giacalone, unaware it contained peanut butter, went into anaphylactic shock after taking a bite.

In a three-week civil trial, her family was awarded \$29.5 million when the jury found that the responding ambulance service negligently treated her allergic reaction.





Texas jury awards \$730 million in oversized load fatality case

By The Trucker News Staff - November 30, 2021



This image still from a dashboard video recorder shows a white Buick driven by Toni Combest being obliterated after striking an over-sized load on a rural Texas highway. She was killed on impact. (Courtesy: Attorney Brent Goudarzi's office)



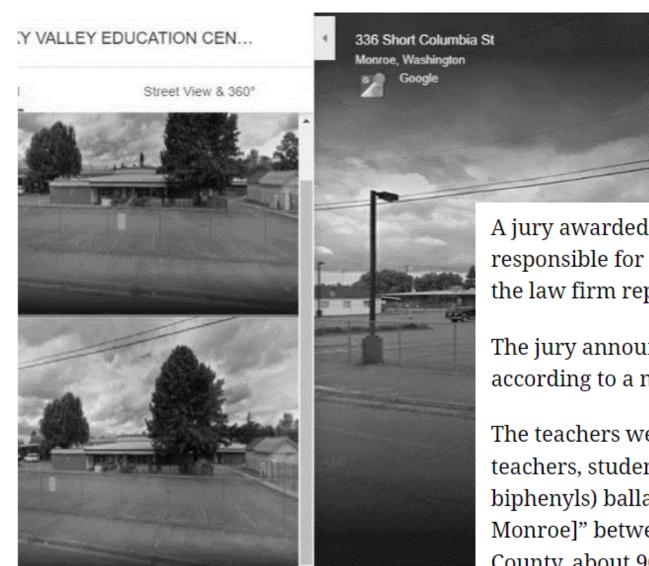


Monsanto must pay WA teachers \$185M in fluorescent light 'poisoning' suit, jury finds

BY BROOKE WOLFORD

JULY 29, 2021 4:28 PM





A jury awarded three teachers \$185 million after Monsanto was found to be responsible for "poisoning teachers, students and parents" at a Washington school, the law firm representing the teachers said.

The jury announced its <u>verdict</u> July 27 in the case of Erickson et. al. v. Monsanto, according to a news release from <u>Friedman Rubin</u>, a Seattle-based law firm.

The teachers were the first plaintiffs to reach a trial after "a group of over 200 teachers, students and parents [were] exposed to leaking PCB (Polychlorinated biphenyls) ballasts in fluorescent light fixtures at the [Sky Valley Education Center in Monroe]" between 2011 and 2016, the firm said. Monroe is located in Snohomish County, about 90 minutes north of Tacoma.

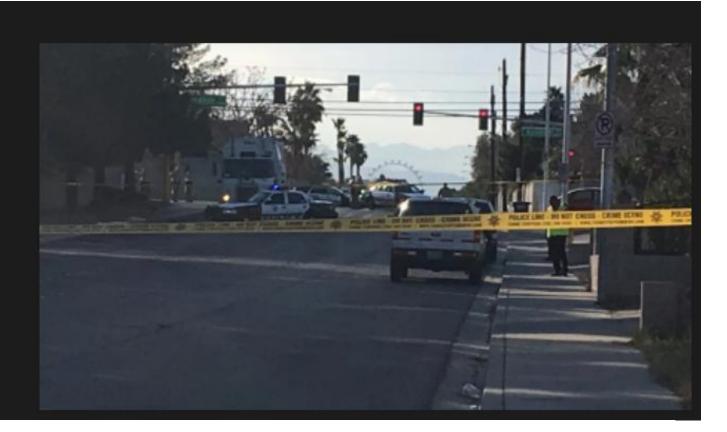
Three teachers were awarded \$185 million in a suit against Monsanto for "decisions which led to the poisoning of hundreds of teachers, students and parents" at a school in Monroe, Washington. *Google Maps*





NEWS

Jury awards family of girl killed by garbage truck \$38.8M in wrongful death lawsuit



by: <u>Caroline Bleakley</u> Posted: Aug 24, 2021 / 11:52 AM PDT Updated: Aug 24, 2021 / 04:49 PM PDT

LAS VEGAS (AP) — A jury in Las Vegas has awarded \$38.8 million in damages to the family of an 11-year-old girl who was struck and killed by a trash truck as she walked home from school in February 2017.

The Clark County District Court jury on Tuesday found the region's contract waste hauler, Republic Services, liable for the death of Jazmin Espana following a two-week trial that the judge called difficult and full of sadness.

In a statement, Republic Services expressed condolences to the girl's family and friends, called her death a tragic accident and maintained that the company has "a strong culture committed to safety."





Target hit with \$4.6 million jury verdict at trial; retailer had nixed \$12K settlement offer

BY STEPHANIE FRANCIS WARD (http://www.abajournal.com/authors/20/)

POSTED SEPTEMBER 12, 2016, 4:00 PM CDT



Target recently got hit with a \$4.6 million jury verdict after a South Carolina woman in 2014 was stuck with a hypodermic needle her 8-year-old daughter found in the store parking lot.

The Minneapolis company rejected a \$12,000 offer to settle the case before trial, and responded with a counteroffer of \$750, the Independent Mail

(http://www.independentmail.com/story/news/local/2016/09/09/j ury-anderson-woman-gets-46-million-target-lawsuit/90129402/) reported.

As Carla Denise Garrison was exiting her car, she saw her daughter pick up the needle, and she swatted it out of the child's hand, which resulted in the needle getting stuck in Garrison's palm, the article reports.





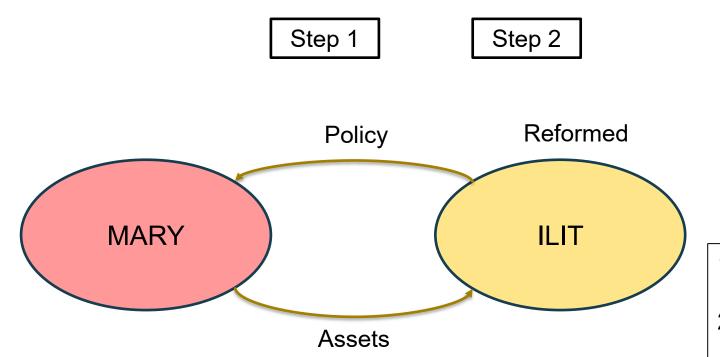
| Creditor Proof Life Insurance State | es (Limits on amount protected will vary) | | | |
|-------------------------------------|---|--|--|--|
| By Population | Alphabetical Order | | | |
| Texas | Alabama | | | |
| Florida | Arizona | | | |
| New York | Arkansas | | | |
| Pennsylvania | Delaware | | | |
| Illinois | District of Columbia | | | |
| Ohio | Florida | | | |
| Georgia | Georgia | | | |
| North Carolina | Hawaii | | | |
| Michigan | Idaho | | | |
| Virginia | Illinois | | | |
| Arizona | Indiana | | | |
| Tennessee | lowa* | | | |
| Massachusetts | Kansas | | | |
| Indiana | Kentucky | | | |
| Missouri | Louisiana | | | |
| Maryland | Maryland | | | |
| South Carolina | Massachusetts | | | |
| Alabama | Michigan | | | |
| Louisiana | Mississippi* | | | |
| Kentucky | Missouri | | | |
| Oregon | Montana | | | |
| Oklahoma | Nevada | | | |
| Utah | New Mexico | | | |
| lowa* | New York | | | |
| Nevada | North Carolina | | | |
| Arkansas | Ohio | | | |
| Kansas | Oklahoma | | | |
| Mississippi* | Oregon | | | |
| New Mexico | Pennsylvania | | | |
| Idaho | South Carolina | | | |
| Hawaii | South Dakota | | | |
| Montana | Tennessee | | | |
| Delaware | Texas | | | |
| South Dakota | Utah | | | |
| Vermont | Vermont | | | |
| District of Columbia | Virginia | | | |
| Wyoming | Wyoming | | | |

None of these states, to the knowledge of the authors, provide protection for the ownership of term life insurance, although term life insurance policies typically are considered to have a negligible value unless the insured is in poor health and not able to replace the policy.





MARY'S ILIT FOR DESCENDANTS (OR DID RECIPRICAL TRUST RULE APPLY AND THEY DID NOT KNOW THIS?)



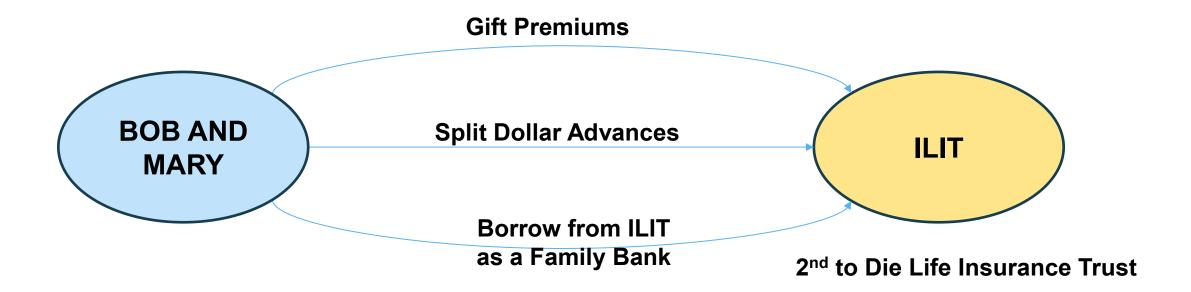
Mary may exchange policy for a policy that has lifetime nursing/care benefits.

- 1. May spray income to lower bracket family members.
- 2. May spray income to charity.
- 3. May receive vacation home and pay vacation home taxes (up to \$40,000 per year).
- 4. May become 678 Trust for a child and buy a home for the child.
- 5. May become 678 Trust and own part of family business to get 199a income tax deduction.
- 6. May buy 529 college savings plan.





BOB AND MARY AND 2ND TO DIE LIFE INSURANCE TRUST



Keep Policy in ILIT until 2030?

Buy policy from ILIT and use it as a savings vehicle.

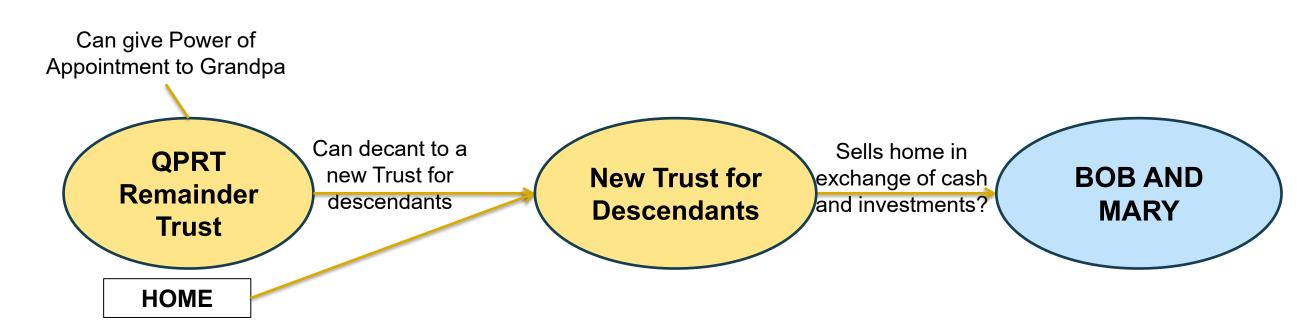
Let ILIT then be a non-life insurance trust and do one or more of the things described in past slides.

May repurpose second to die coverage or make partial withdrawal to purchase other coverages or investments.





BOB AND MARY AND QPRT



Considerations:

- 1. No step up in basis on death of Bob or Mary.
- 2. Possibly no \$250,000/\$500,000 exemption on sale after the death of one spouse.
- 3. IRC Section 2703 requires a QPRT to not allow a transfer or sale of the home to the Grantor or spouse thereof. If this happens, then the transfer of the home to the QPRT will be considered to be the gift of the entire value of the home retroactive to the date of funding.

May receive a life insurance policy in exchange for home or other investments used for family.

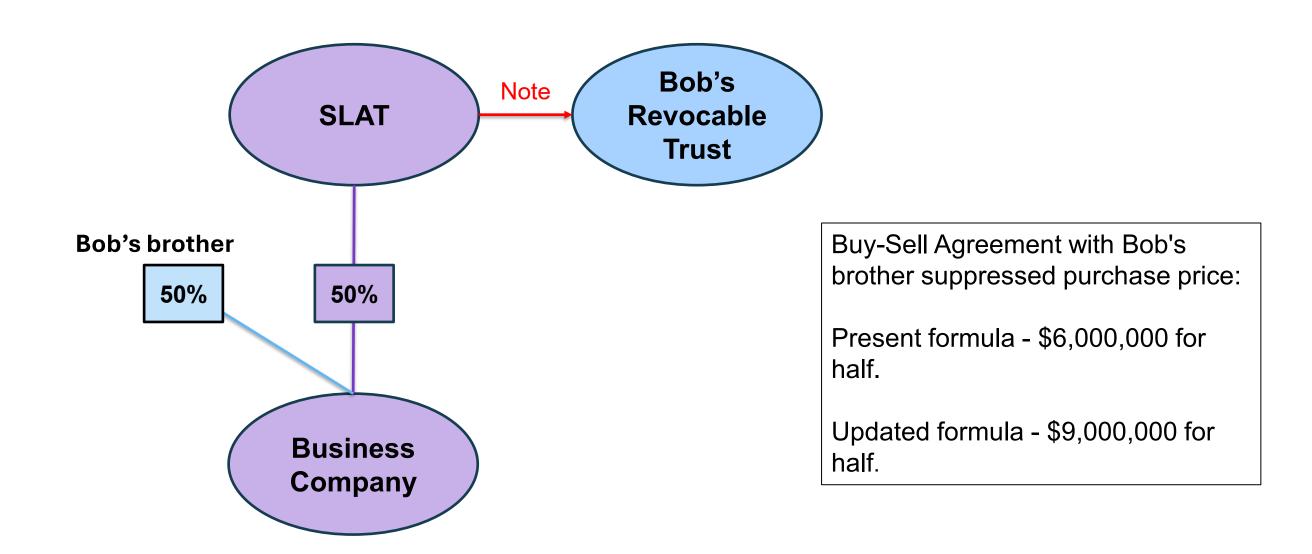
May require court approval after notice to all beneficiaries and appointment by court of an ad litem to represent minor and unborn beneficiaries.

Home is owned by Bob and Mary again to qualify for \$500,000 exemption on sale and get new fair market value income tax basis on death. No more rent payable to QPRT.





BOB AND MARY PLANNING







WHAT CAN THE SLAT BECOME---POSSIBLE IRREVOCABLE TRUSTS TO CONSIDER

Make SLAT complex to be separately taxed.

Keep as disregarded (Grantor pays income tax and may exchange assets)

Section 678 Trust

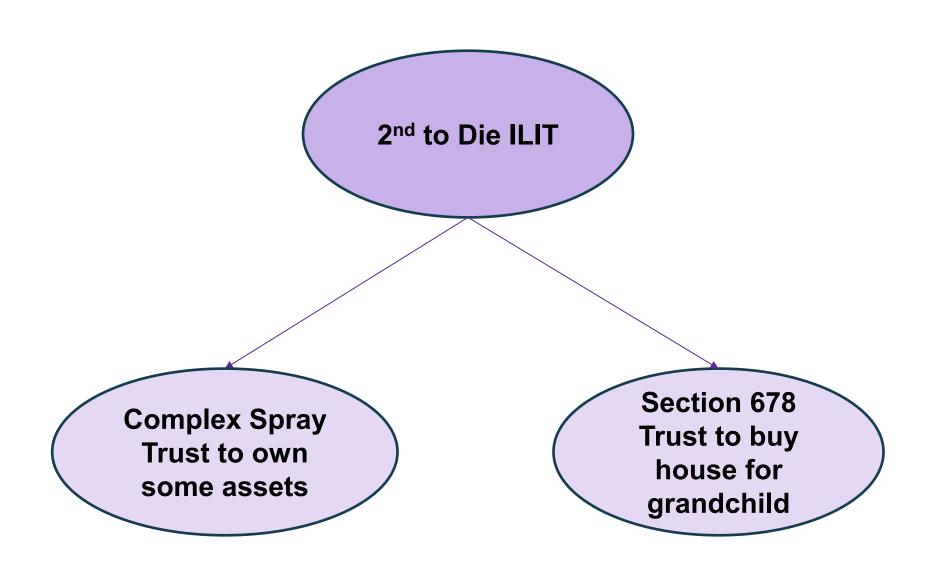
- 1. Spray income to lower bracket beneficiaries.
- 2. Spray income to charity.
- 3. Add property and pay property taxes.

May own child's homestead to obtain \$250,000/\$500,000 exemption and let child deduct property taxes.





WHAT CAN A SECOND TO DIE ILIT **DECANT INTO?**



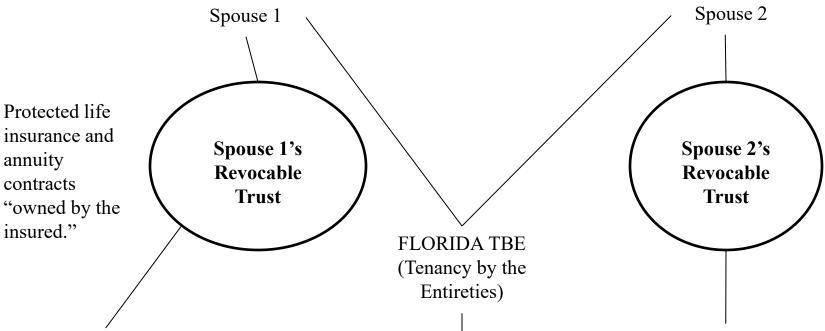




DETERMINING HOW TO BEST ALLOCATE ASSETS AS BETWEEN A MARRIED COUPLE - PART I

General Rules:

- -Typically want each trust funded with at least \$11,200,000 worth of assets on death for estate tax planning.
- May be funded from ½ of tenancy by the entireties assets via disclaimer and probate or by life insurance/pension/IRA assets.



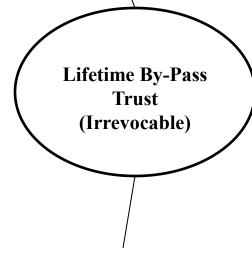
- 1. Assets held directly by revocable trust are subject to Spouse 1's creditor claims.
- 2. Direct ownership of limited partnership or LLC not in TBE may have charging order protection (meaning that if a creditor obtains a lien on the limited partnership or LLC, the Spouse 1 cannot receive monies from the limited partnership or LLC without the creditor being paid).
- 1. Only exposed to creditors if both spouses owe the creditor, if one spouse dies and the surviving spouse has a creditor, the spouses divorce, or state law or the state of residence changes.
 - On death of one spouse, surviving spouse may disclaim up to ½ (if no creditor is pursuing the **deceased** spouse) to fund By-Pass Trust on first death.
- 1. Safe from creditors of Spouse 1 but exposed to creditors of Spouse 2 (Maintain large umbrella liability insurance coverage to protect these assets.)
- 2. On Spouse 2's death, can be held under a protective trust, which will continue to be safe from creditors of Spouse 1, subsequent spouses, and "future new family."

Trustee other than Spouse
1 or Spouse 2

Gifting Trust
(Irrevocable)

- 1. Safe from creditors of both spouses.
- 2. If divorce occurs, should not be subject to rules for division of property between spouses.
- 3. May be controlled by the "entrepreneurial spouse" by using a Family Limited Partnership.

Spouse 2 could be Trustee if Spouse 1 is sole grantor (or vice versa)



- 1. Safe from the creditors of the Grantor's spouse.
- 2. If funded by one spouse, may benefit other spouse and children during the lifetime of both spouses.
- 3. Otherwise can be identical to gifting trust pictured to the left.

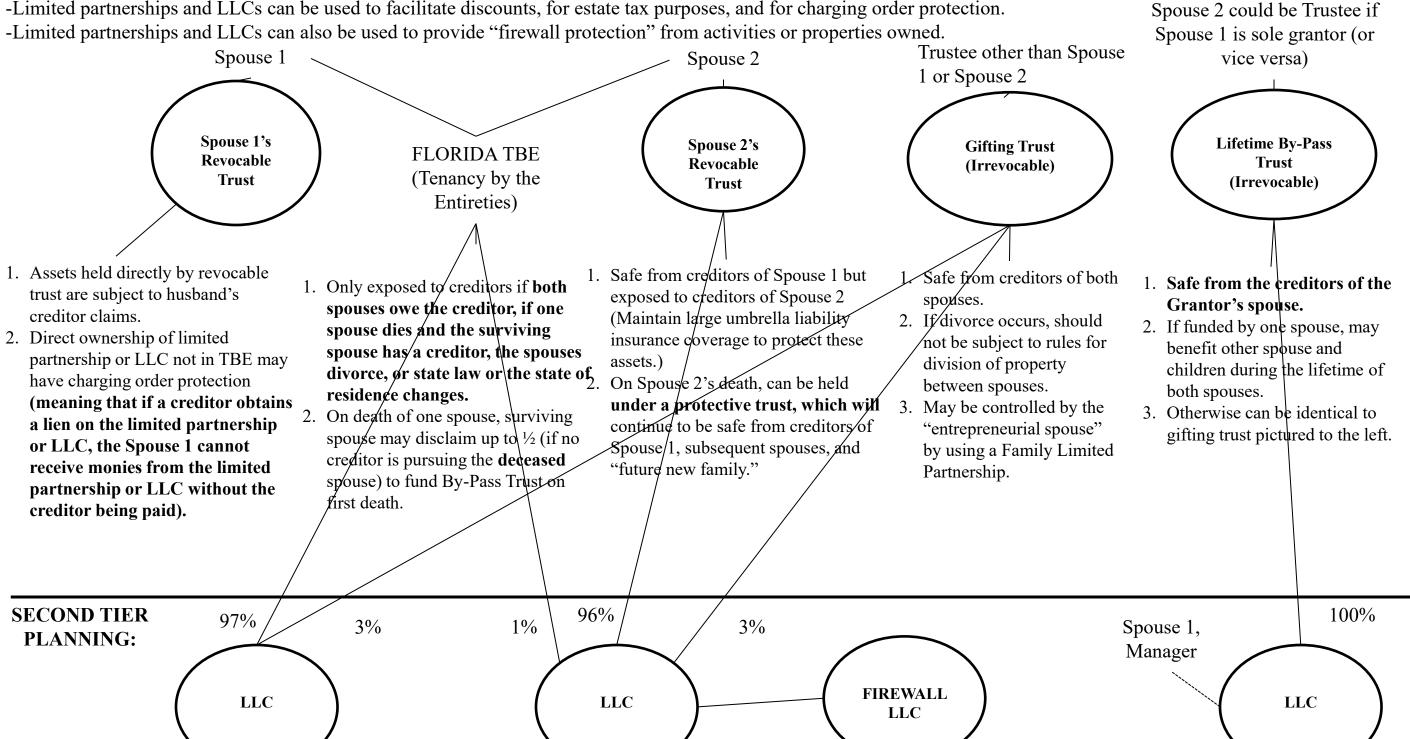
SEE NEXT PAGE FOR SECOND TIER PLANNING

<u>A COMMON SOLUTION</u> - to use a limited partnership or similar mechanisms and have no assets directly in the "high risk" spouse's trust, half to two-thirds of the assets held as tenants by the entireties, and half to two-thirds of the assets directly in the "low risk" spouse's <u>trust</u>.

DETERMINING HOW TO BEST ALLOCATE ASSETS AS BETWEEN A MARRIED COUPLE - PART II

Subsidiary Entity Techniques:

-Limited partnerships and LLCs can be used to facilitate discounts, for estate tax purposes, and for charging order protection.



Property or activity

A COMMON SOLUTION - to use a limited partnership or similar mechanisms and have no assets directly in the "high risk" spouse's trust, half to two-thirds of the assets held as tenants by the entireties, and half to two-thirds of the assets directly in the "low risk" spouse's trust.



Leveraged Investment



Basic Income Tax Operation of Each Typeof Trust

Grantor Trust

Grantor treated as the owner for federal income tax purposes.

Can make protective ESBT election.

If anyone but the Grantor makes a contribution, it is no longer a Grantor Trust!

Beneficiary Defective Trust (aka BDIT or 678 Trust)

Beneficiary treated as owner for federal income tax purposes.

678 Income Trust

If beneficiary has the right to withdraw all income then all income will pass by K-1 to beneficiary regardless of whether it is distributed.

Complex Trust

- 1. Taxed as a separate entity to the extent that income is not distributed
- 2. "Distributable Net Income" paid out can carry the income to lower bracket taxpayers
- 3. The trust has an effective tax rate of 24.1% on the first \$12,500 of income and 37% above that.
- 4. Distributions made within 65 days of the next tax year can be considered to have been made in the previous tax year.
- 5. Distributions made to charity can carry income to the charity to in effect give a tax deduction without a 60% adjusted gross income limitation or itemized deduction considerations.
- 6. 3.8% Medicare tax begins to apply at \$12,500+ of AGI.
- 7. Unlike a C Corporation No tax upon liquidation of the trust.
- 8. Can shield Trustee and Beneficiaries from operational liability similar to a corporation depending upon state law.
- 9. No 179 Deduction
- 10. Separate \$10,000 SALT deduction.

Complex
Electing Small
Business Trust
"ESBT"

- 1. Can be owner of an S-Corporation.
- 2. Can allow a non-resident alien beneficiary to effectively be a member of an S-Corporation.
- 3. S-Corporation income taxed at the highest rate bracket, regardless of whether income is distributed to beneficiaries.
- 4. ESBTs may have multiple beneficiaries, and mandatory distributions of income are not required.
- 5. Distributions made to charity will be subject to the same rules that apply to individuals.
- 6. 3.8% Medicare tax begins to apply at \$12,500+ of AGI.

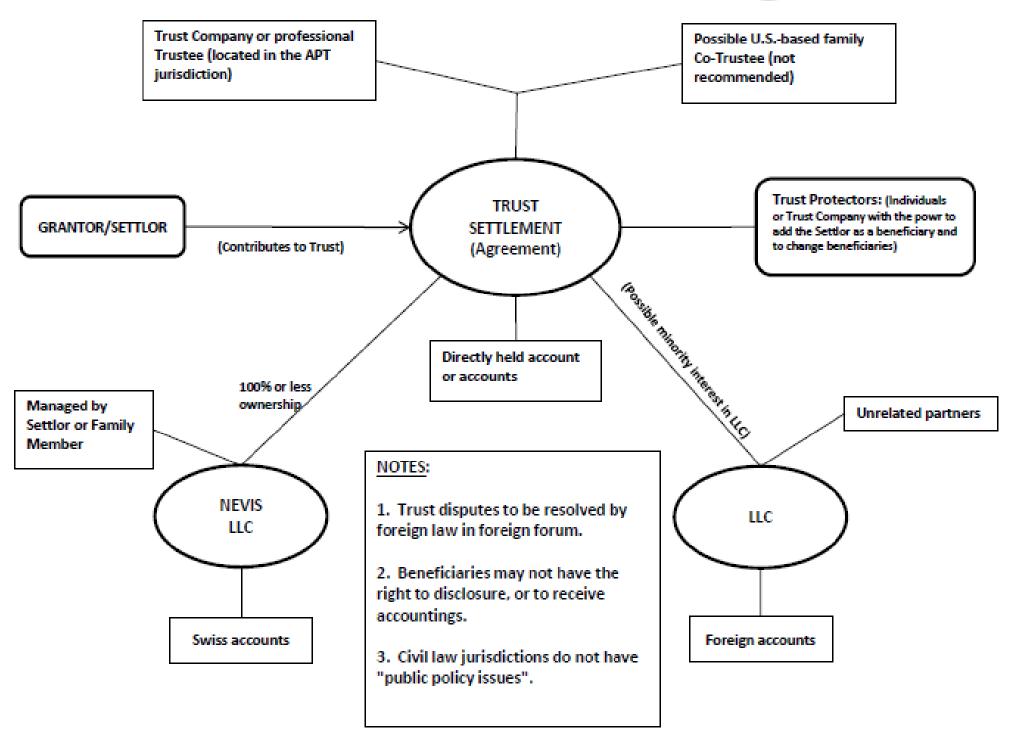
Qualified Subchapter S Trust "QSST"

- Can be owner of an S-Corporation.
- 2. Can have only one named beneficiary.
- 3. Must pay all "fiduciary accounting income" to trust beneficiary each year.
- 4. All S-Corporation K-1 income taxed to beneficiary of trust.





The Typical Offshore or **APT State Trust Arrangement**







Married Couples Trust Decision Chart

| Step-Up in | JEST (Joint Exempt Step-Up Trust) Probably | Tenants by the Entireties Trust Only Half of a | Joint Trust - Not TBE, JEST, or CPT Depends | Florida Community Property Trust Probably Yes | Tennessee Community Property Trust Probably Yes | South Dakota Community Property Trust Probably Yes | Alaska Community Property Trust Probably Yes | Kentucky Community Property Trust Probably Yes |
|--|---|---|---|--|--|---|---|--|
| Basis After First Death | Yes | Step-Up | Upon Drafting and Logistics | | | | | |
| Creditors of One Spouse Can Reach Trust Assets | Yes — the Debtor Spouse's Share | Protected from Either Spouse's Creditors | Depends Upon Trust Drafting | One-Half of Trust Assets Exposed to One Spouse's Creditors | One-Half of Trust Assets Exposed to One Spouse's Creditors | All of Trust Assets Exposed to One Spouse's Creditors | All of Trust Assets Exposed to One Spouse's Creditors | One-Half of Trust Assets Exposed to One Spouse's Creditors |
| Can Create Credit Shelter Trust With More Than Half of the Trust Assets | Yes, All Trust Assets May Go Into Credit Shelter Trusts | Up to Half, But Only by Disclaimer or Surviving Spouse Will Not Have a Power of Appointment | Depends Upon Drafting – Be Careful! | Only as to One-Half | Only as to One-Half | Only as to One-Half | Only as to One-Half | Only as to One-Half |
| May Share Upon Divorce as Set Forth in Pre- or Post- Nuptial Agreement | Yes | Probably Not | Yes | Yes – Spouses can agree on the dissolution of property Fla Stat. 736.1508 | Yes – Spouses can agree on the dissolution of property | Yes – Spouses can agree on the dissolution of property | Yes – Spouses can agree on the dissolution of property | Yes – Spouses can agree on the dissolution of property |

*Chart continued on next slide





Married Couples Trust Decision Chart, Cont'd

| | JEST (Joint Exempt Step-Up Trust) | Tenants by the Entireties Trust | Joint Trust - Not TBE, JEST, or CPT | Florida Community Property Trust | Tennessee Community Property Trust | South Dakota Community Property Trust | Alaska Community Property Trust | Kentucky Community Property Trust |
|--|---|---------------------------------------|-------------------------------------|---|---|---|---|---|
| May Be Converted from Former Joint or Individual Trust | Yes | Yes | N/A | No – Must Be Created On or After July 1, 2021 as a new Florida Community Property Trust | N/A | Yes | Yes | Yes |
| Complicated to Draft? | Yes | Simpler than JEST | Will Depend Upon Specifics | Simple to Draft if the Statute is Followed | Simple to Draft if the Statute is Followed | Simple to Draft if the Statute is Followed | Simple to Draft if the Statute is Followed | Simple to Draft if the Statute is Followed |
| Requires a "Qualified" Trustee | No | No | No | Yes | Requires a Tennessee Trustee | Requires a South Dakota Trustee | Requires an Alaska Trustee | Requires a Kentucky Trustee |





Community Property Trust Features- Florida

| State | Requirements | Creditor Protection | Property Included | U.S.C. s. 1014(b)(6) | |
|---------|---|-------------------------|-------------------------|--------------------------------|--|
| Florida | (1) Expressly declares that the trust is a | (1)An obligation | All property owned by | 36.1511 Application of | |
| | community property trust within the meaning of | incurred by only one | a community property | Internal Revenue Code; | |
| | this part | spouse before or during | trust is community | community property | |
| | (2) Has at least one trustee who is a qualified | the marriage may be | property under the laws | classified by another | |
| | trustee, provided that both spouses or either | satisfied from that | of the state during the | jurisdictionFor purposes | |
| | spouse also may be a trustee | spouse's one-half share | marriage of the settlor | of the application of s. | |
| | (3) Is signed by both settlor spouses consistent | of a community | spouses. | 1014(b)(6) of the Internal | |
| | with the formalities required for the execution of | property trust. | | Revenue Code of 1986, 26 | |
| | a trust under this chapter. | (2) An obligation | | U.S.C. s. 1014(b)(6), as of | |
| | (4) Contains substantially the following | incurred by both | | January 1, 2021, a | |
| | language in capital letters at the beginning of the | spouses during the | | community property trust is | |
| | community property trust agreement: | marriage may be | | considered a trust | |
| | THE CONSEQUENCES OF THIS COMMUNITY | satisfied from a | | established under the | |
| | PROPERTY TRUST MAY BE VERY | community property | | community property laws of | |
| | EXTENSIVE, INCLUDING, BUT NOT LIMITED | trust of the settlor | | the state. Community | |
| | TO, YOUR RIGHTS WITH RESPECT TO | spouses. | | property, as classified by a | |
| | CREDITORS AND OTHER THIRD PARTIES, | | | jurisdiction other than this | |
| | AND YOUR RIGHTS WITH YOUR SPOUSE | | | state, which is transferred to | |
| | DURING THE COURSE OF YOUR MARRIAGE, | | | a community property trust | |
| | AT THE TIME OF A DIVORCE, AND UPON THE | | | retains its character as | |
| | DEATH OF YOU OR YOUR SPOUSE. | | | community property while in | |
| | ACCORDINGLY, THIS TRUST AGREEMENT | | | the trust. If the trust is | |
| | SHOULD BE SIGNED ONLY AFTER CAREFUL | | | revoked and property is | |
| | CONSIDERATION. IF YOU HAVE ANY | | | transferred on revocation of | |
| | QUESTIONS ABOUT THIS TRUST | | | the trust, the community | |
| | AGREEMENT, YOU SHOULD SEEK | | | property as classified by a | |
| | COMPETENT AND INDEPENDENT LEGAL | | | jurisdiction other than the | |
| | ADVICE. | | | state retains its character as | |
| | | | | community property to the | |
| | | | | extent otherwise provided by | |
| | | | | ss. 732.216-732.228. | |





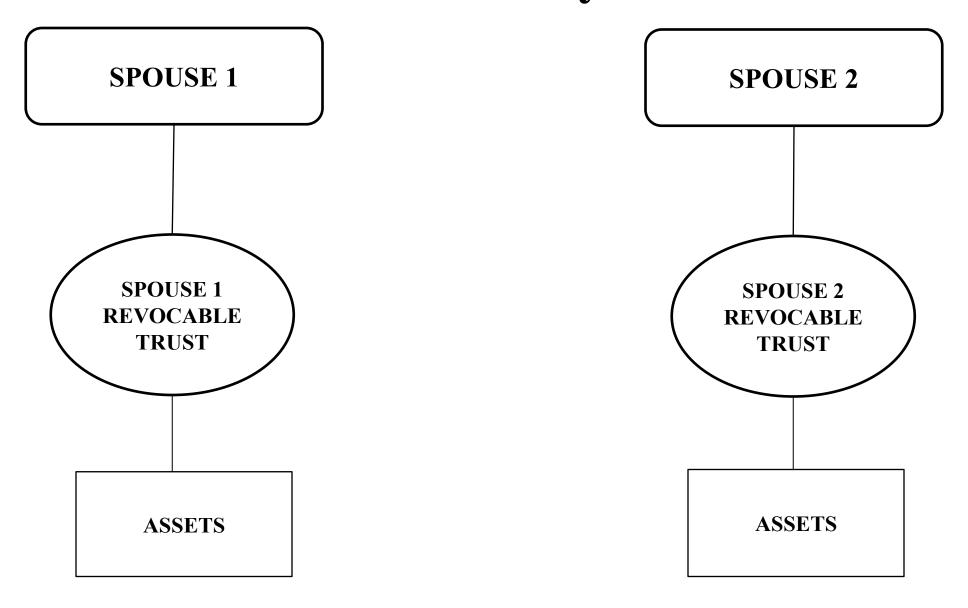
The JEST Trust

(JEST means Joint Exempt Step Up Trust and allows for full step up and full funding of the credit shelter amount on first death)





Traditional Wealthy Floridian



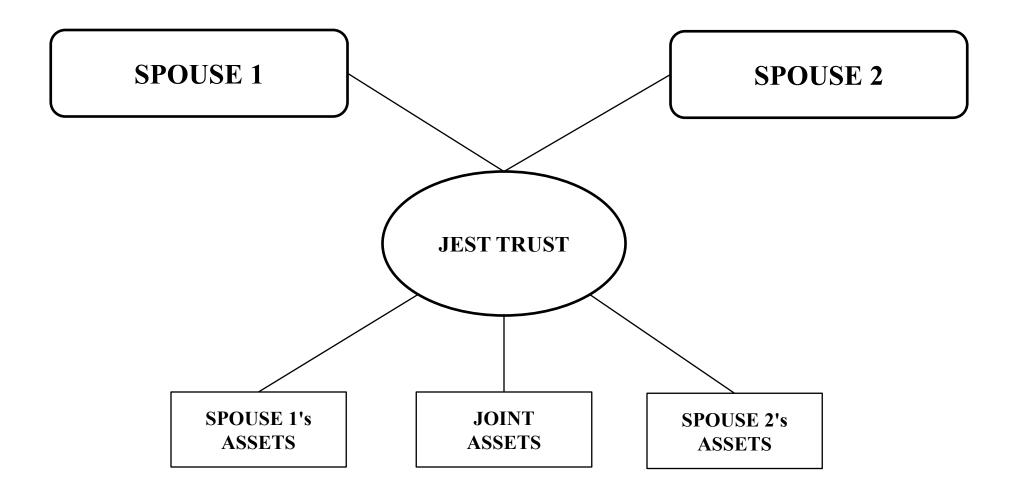
On first death, Trust of first dying spouse becomes irrevocable. Credit Shelter Trust to avoid estate tax and protect assets of first dying spouse.

Assets of surviving spouse - flap in the wind.





JEST Trust



On first death, up to exemption amount of first dying spouse (as much as \$13,990,000), may pass to Credit Shelter Trust or Trusts to benefit surviving spouse and descendants, with a possible full step-up of all assets - excess assets going into QTIP Trusts, which may also qualify for full step-up.



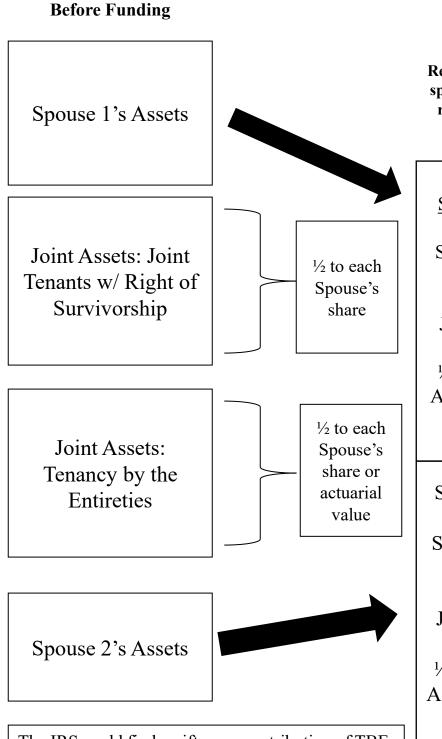


Joint Exempt Step-Up Trust (JEST) Chronology - The 4 Steps from Drafting to Implementing

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Derived from articles that can be found on Leimberg Information Services (Estate Planning Newsletter #2086)

and Estate Planning Magazine October and November 2013 Editions
Step 2
Step 3
Results of JEST Technique



The IRS could find a gift upon contribution of TBE assets to the joint revocable trust, but this gift will qualify for the marital deduction if recipient spouse can withdraw what is added to Spouse 1 or Spouse 2's share. Also see PLR 200201021.

Funding of Joint Division upon First Dying Revocable Trusts; each Spouse's Death spouse has the right to **Assume Spouse 1 dies first** revoke his/her share until first death Credit Shelter Trust A Funded from Spouse 1's Spouse 1's Share Share in the amount of Spouse 1's available Estate Spouse 1's Assets Tax Exemption (ETE) ½ of former JTWROS Assets Q-TIP Trust A If Spouse 1's Share exceeds ½ of former TBE Spouse 1's available ETE, Assets (or by other the excess will fund this trust percentage) Credit Shelter Trust B Spouse 2's Share If Spouse 1's Share is less than his available ETE, Spouse 2's Share will fund this trust in the Spouse 2's Assets amount of Spouse 1's remaining ETE (But not in ½ of former excess of Spouse 2's available ETE) JTWROS Assets Q-TIP Trust B ½ of former TBE If Spouse 2's Share has Assets (or by other any remaining assets, percentage) they will be used to fund

CST A and CST B can be merged if there is no concern with estate tax, stepped-up basis, creditor protection, or credit shelter trust effectiveness. Q-TIP Trust A and Q-TIP Trust B can be merged if there is no concern with respect to stepped-up basis or creditor protection effectiveness.

Step 3 Note:

this trust

- -For Spouse 2 & Descendants benefit (limited by ascertainable standard)
- Assets will receive a stepped-up basis
- -Assets are protected from Spouse 2's creditors
- Assets escape estate tax on Spouse 2's death
- Spouse 2 can be beneficiary of income and principal
- -Assets will receive a stepped-up basis on Spouse 1's death, and then again on Spouse 2's death
- -Assets included in Spouse 2's taxable estate
- -Will be protected from Spouse 2's creditors
- -Assets may receive a stepped-up basis, but this is more likely if Spouse 2 is not a beneficiary
- -May escape estate tax liability on Spouse 2's death
- -For creditor protection and estate tax exclusion purposes, CST B may be moved to an APT jurisdiction

Special Consideration: If Spouse 2 is found to have made a gift of trust assets to Spouse 1 upon Spouse 1's death, this gift may qualify for the marital deduction

If IRS argues that Spouse 2 has gifted to trust the gift will be incomplete because of Spouse 2's power of appointment

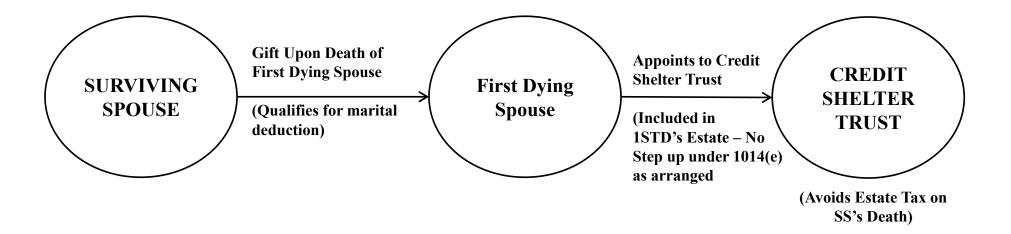
- -Spouse 2 will be income beneficiary
- -Assets may receive a stepped-up basis on Spouse 1's death & again on Spouse 2's death
- -Assets included in Spouse 2's estate
- -May not be protected from Spouse 2's creditors unless moved to APT trust jurisdiction
- -If IRS argues that Spouse 2 has gifted to trust the gift will be incomplete because of Spouse 2's power of appointment





Basic JEST Anatomy

1993 Technical Advice & 2001 and 2002 Private Letter Rulings



Blattmachr Article

Credit Shelter Trust could be found to be funded by surviving spouse under step transaction doctrine so creditor may invade the trust in most states.

<u>Mulligan</u>

If first dying spouse needs approval of surviving spouse to appoint then 2041 may not apply, could be considered as a gift of ½ by the surviving spouse – but 1933 Johnston case held otherwise in a similar situation.

Zaritsky 2015 Heckerling Presentation.

Will the service consider the surviving spouse to have funded the credit shelter trust or trusts by reason of the step transaction doctrine?





JEST Credit Shelter Trust B Planning

ALTERNATIVE A **CREDIT SHELTER** TRUST B **ALTERNATIVE** Formed from assets of the share of the surviving spouse.

Expected to be considered as being transferred to Credit Shelter Trust B by the first dying spouse for federal estate tax purposes pursuant to Private Letter Ruling 200101021 and Private Letter Ruling 200210051.

The IRS could claim that Credit Shelter Trust B was funded by the surviving spouse.

Strategy 1 - Incomplete Gift Treatment

The surviving spouse maintains a Power of Appointment over the Trust assets, which causes the Trust to be considered as an incomplete gift for federal gift tax purposes, and the Trust assets will be considered as owned by the surviving spouse for estate tax purposes on his or her death.

In light of the IRS' position in CCA 201208026, it is best to give the surviving spouse a lifetime Power of Appointment over the assets in Credit Shelter Trust B to assure that an incomplete gift results for federal gift tax purposes.

If there are separate children for each spouse or a concern that the surviving spouse might not appropriately exercise a Power of Appointment, then it could be limited to being exercisable only with a consent of non-adverse parties, or limited to the extent needed to avoid imposition of federal gift tax by funding under a formula clause.

Accepted as funded by first dying spouse.

Will not be subject to estate tax at the level of the surviving spouse.

Will not be subject to creditor claims of the surviving spouse.

This is the optimum result.

Considered as funded by surviving spouse.

Might be subject to estate tax at the level of the surviving spouse.

Might be subject to creditor claims of the surviving spouse, unless local law of the Trust provides otherwise.

Strategy 2 - Complete Gift Treatment

If the surviving spouse disclaims all Powers of Appointment over the Trust, then the transfer to Credit Shelter Trust B is considered to be a complete gift by the surviving spouse, and the Trust will not be subject to federal estate tax of the surviving spouse's estate.

The value of the assets passing to Credit Shelter Trust B would reduce the surviving spouse's \$11,400,000 exemption.

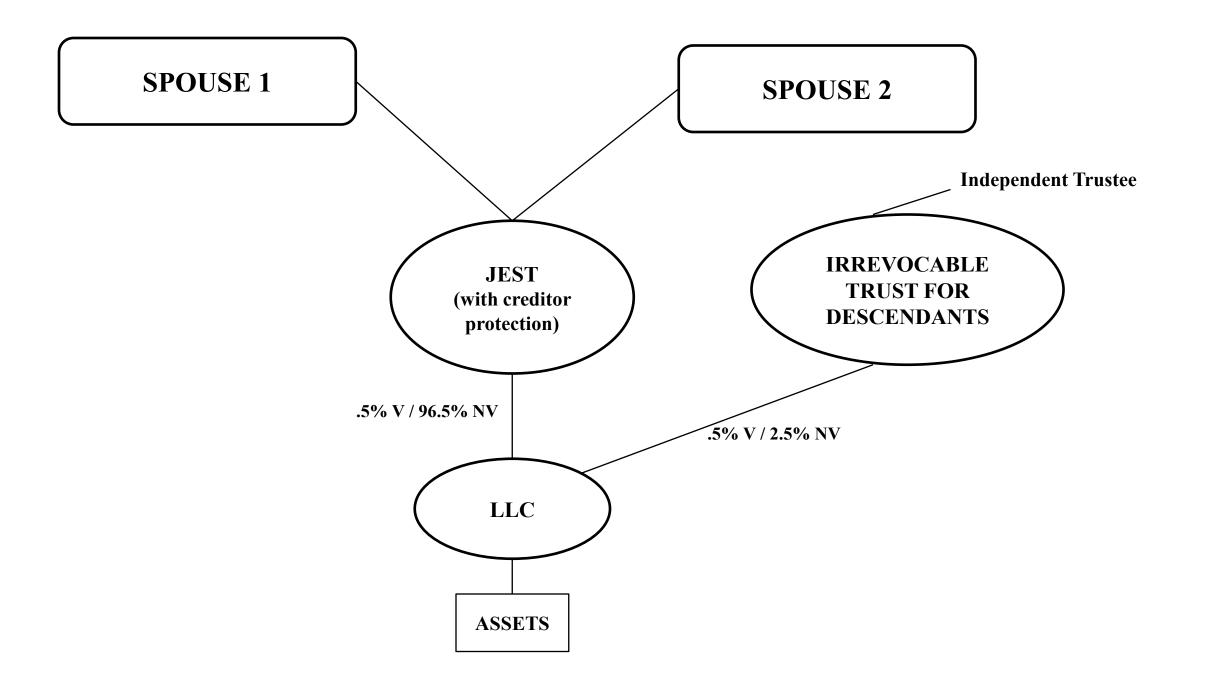
Give the surviving spouse the power to replace Trust assets with assets of equal value, so then it can be considered a Defective Grantor Trust if this occurs.

Note (applicable to both Strategy 1 and Strategy 2): Situs Credit Shelter Trust B in an "asset protection trust jurisdiction" to avoid having creditors be able to reach into the Trust, and also to avoid the Trust being included in the surviving spouse's estate if the surviving spouse was considered as a contributor to the Trust for federal estate and gift tax purposes.





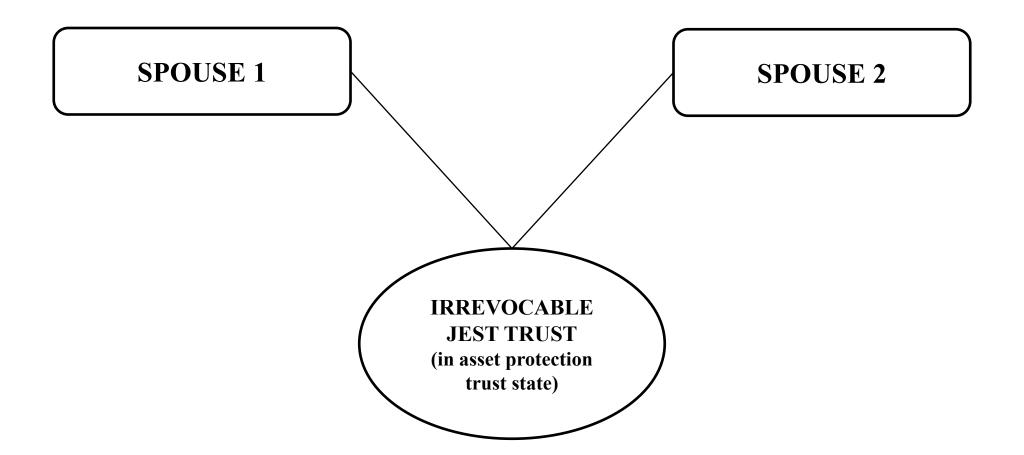
JEST with Some Creditor Protection







Irrevocable JEST Trust



Where a couple has concerns that they may be subject to undue influence, distortion or loss of assets and direction from dementia, or otherwise, why not make the Trust irrevocable, and to also possibly provide that transfers are "incomplete gifts" by having each spouse reserve the right to veto distributions and to appoint the Trust assets (with the Power of Appointment being subject to the consent of a non-adverse party) in addition to having other JEST Trust terms to obtain a stepped-up basis on each spouse's death.



Irrevocable Multiple JESTs – Possession is 90% of the Law And never the twain shall meet. **SPOUSE 1 SPOUSE 2** (Mark Twain) Spouse 1, Spouse 2, Son Co-Trustees Spouse 1, Spouse 2, Daughter Co-Trustees **IRREVOCABLE IRREVOCABLE JEST TRUST 1 JEST TRUST 2** (One-half of assets) (One-half of assets) **Becomes Generation-Skipping Becomes Generation-Skipping** Trust for son and his descendants Trust for son and his descendants on death of surviving parent. on death of surviving parent.

This trust has been funded for the primary purpose of benefitting the Grantor's during our lifetime, and then having a protective trust or trusts established for our daughter, Molly Hatchett, to the extent of assets then remaining. Our son, Leonard Skin-Us is the Trustee of another trust that will be held for his benefit.

Distributions to my said child and his/her descendants shall therefore reduce his/her subsequent inheritance. Either child may require that a licensed trust company serve as additional Co-Trustee of each trust, and both of our children will receive annual accountings prepared by our certified public accountant of each trust. We, as Grantors, may further exercise our power to reappoint trust assets, but only after a four hour neurological examination and verification that we are not known to be subject to undue influence, and have received approval from any two of the following five trusted non-related individuals ...





Traditional Use of Irrevocable Life Insurance Trusts

Estate planners historically used **Irrevocable Life Insurance Trusts** to keep life insurance proceeds out of the taxable estate. **Irrevocable Life Insurance Trusts** also provide creditor protection and ensure that policy proceeds follow a structured estate plan.

When structured properly, Irrevocable Life Insurance Trusts

Avoid estate inclusion for federal estate tax purposes under IRC § 2042

Allow gifts of premiums to qualify for the annual exclusion using Crummey notices

Protect policy proceeds from the surviving spouse's creditors, potential remarriage risks, and improve the prospects of reasonable performance and prudent management that a professional or corporate trustee is involved





Modernization/Conversion of Irrevocable Life Insurance Trusts and Taxation of Life Insurance Trust



Even when life insurance is owned under a properly drafted, irrevocable trust, modernization of the trust may not only be appropriate, but possibly necessary.

There are disadvantages to having a life insurance policy held under a traditional **Irrevocable Life Insurance Trust**. The life insurance trust is not accessible to the grantor of the trust and will pass pursuant to the terms of the trust agreement, which was typically drafted many years in the past and not reflective of the optimum disposition plan that would now be desired if the insured died.

However, a modern Irrevocable Life Insurance Trust will commonly include:

- A provision appointing trust protectors who can amend the trust for family, tax, or legal compliance purposes.
- A protector who can amend or correct clerical or inconsistency areas in the document.
- Savings provisions to avoid inadvertent tax problems that might be caused by an inexperienced or unknowing drafter.
- Specialty provisions, such as whether there would be a floating spouse clause to enable a future spouse of the grantor to benefit from the trust.
- GST exempt trusts to assume that assets can be held for the lifetime of the descendants of the grantor.
- A provision that would enable a person or fiduciary company to give powers of appointment to the surviving spouse or one or more descendants or even other family members in order to allow for assets of the trust that may be purchased with the proceeds of life insurance to receive a fair market value income tax basis on the death of one or more individuals.





- It should be noted, in the case of a traditional **Irrevocable Life Insurance Trust**, that it may be possible to give one or more of the beneficiaries or even third parties a power to appoint trust assets to decedents of the grantor's parents so long as such power holders have no pre-existing understanding, agreement, or duty to exercise the power of appoint in favor of the grantor. However, this type of arrangement has not been approved by the IRS and should be carefully considered before being implemented. (See Jonathan G. Blattmachr et al., *Estate Planning's Most Powerful Toll: Powers of Appointment Refreshed, Redefined, and Reexamined*, 47 Real Prop. Tr. Est. L. J. 529 (2013) (discussing the power of appointment as an estate planner tool).)
- Therefore, even if a Life Insurance Trust is in existence, it may be best to set a new life insurance trust up and to have the new Life
 Insurance Trust be funded with a reasonable amount of cash or other assets. Then, purchase the life insurance policy from the Old Life
 Insurance Trust so that the death benefit and future value attributable to continued premium payments can be held under the new Life
 Insurance Trust.
- Alternatively, the assets of the life insurance policy held under the Old Life Insurance Trust may be decanted to a new Life Insurance Trust if this is permitted under the state law where the Life Insurance Trust is sitused, or the law of a state that the Life Insurance Trust might be moved to by changing trustees.





Modernization/Conversion of Irrevocable Life Insurance Trusts and Taxation of Life Insurance Trust

Income Taxation of Life Insurance Trust

Most life insurance trusts are disregarded grantor trusts for federal income tax purposes because the IRC Section 677 considers a trust to be a grantor trust if the grantor is the insured, at least as to the life insurance policy itself.

Transactions between an individual and a grantor trust and/or the spouse of the Grantor will normally be disregarded for federal income tax purposes as if they never occurred. However, interest paid or accrued as between spouses (or between one spouse and a grantor trust considered as owned by the other spouse) will be taxable as the interest is paid or accrued each year. (See Northern Trust. (2022). Understanding grantor trusts: Tax implications and planning strategies. Retrieved from https://www.northerntrust.com. See also The Tax Adviser. (2020). Planning with irrevocable life insurance trusts. AICPA. Retrieved from https://www.thetaxadviser.com.)



Modernization/Conversion of Irrevocable Life Insurance Trusts and Taxation of Life Insurance Trust

<u>Avoiding Income Tax on Investment Income</u>

Many grantors will prefer not to pay income tax on the income of a grantor trust, and many trustees and beneficiaries will prefer not to have a non-grantor trust pay income tax.

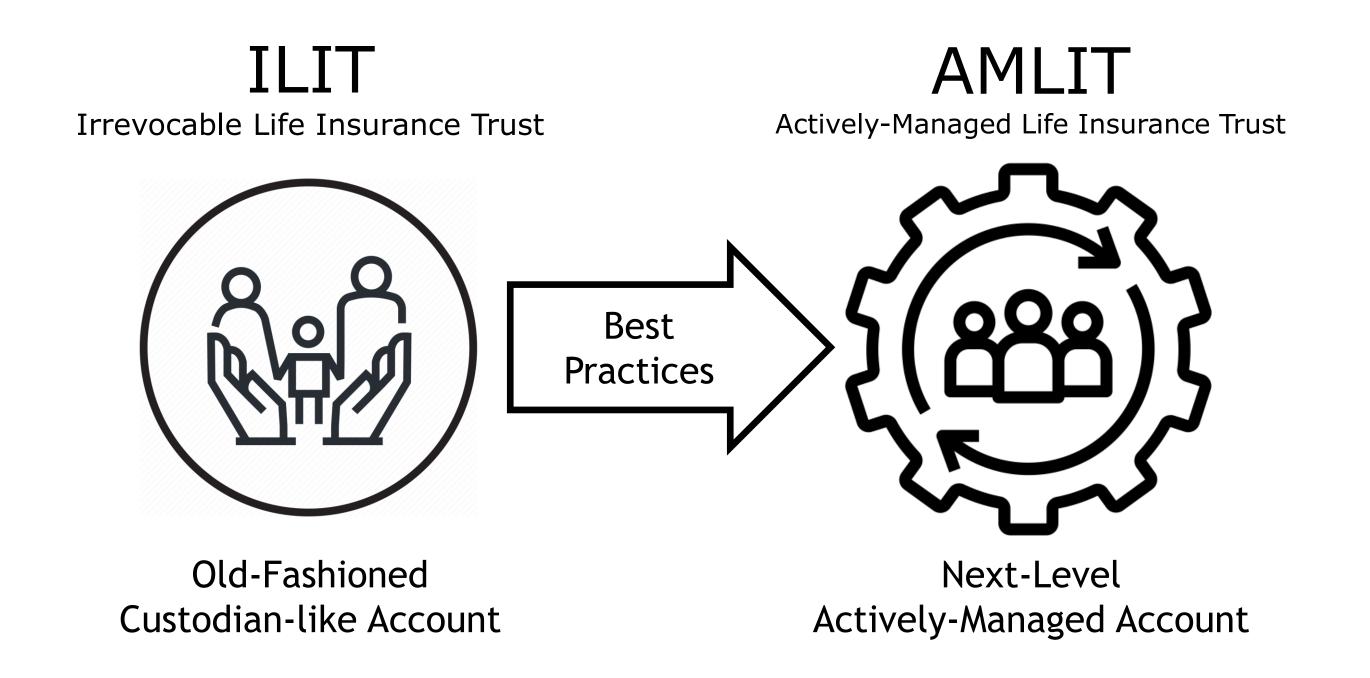
One solution to this will be to invest the trust assets into an economically efficient, investment-based life insurance policy or policies. These policies can in turn be invested in any nu96

mber of stocks, bonds, real estate, or other underlying asset classes. The policies will still provide a death benefit, if one or more of the insured individuals die, and tax-free income during the life of the insureds, as further described herein.





Modernization/Conversion of Irrevocable Life Insurance Trusts









Modernization/Conversion of Irrevocable Life Insurance Trusts

| | ILITs | VS. | AMLITS |
|---|---|-----|--------|
| Gift Request, Crummey Letter & Premium Payment? | | | |
| Funding-Adequacy of CURRENT policy assets? | | | |
| Cost Analysis? [UPIA Section 7 compliance] | ? | | |
| Performance Analysis [UPIA Section 2(c)(5) compliance] | | | |
| Risk Assessment? [UPIA Section 2(b) compliance] | Financial Strength & Lapse but NOT Under-Performanc | | |
| Trades/Exchanges for Cost Savings | ? | | |





Modernization/Conversion of Irrevocable Life Insurance Trusts ILITs vs. AMLITs

Cost Savings (for Qualifying Accounts) used to:

- ☑ Reduce/Eliminate Gifting Requirements
- ☑ Extend Coverage to Reduce/Eliminate Risk of TOTAL Loss
- ☑ Reduce/Eliminate the "Premium Call" Risk
- ☑ Reduce/Eliminate Risk of "Phantom Taxable Income" Risk
- ☑ Withdraw "Excess" Account Values for Re-Investment
- ✓ Increase Death Benefits and/or Account Growth
- ☑ Pay Trust Administration Fees







Modernization/Conversion of Irrevocable Life Insurance Trusts ILITs vs. AMLITs

- ✓ New/Increased Fees for accounts Opting-In for AMLIT Services
- ✓ More AUM Fees on ...
 - ... More Death Benefits
 - ...Longer Death Benefits versus Total Loss
 - ...Life Settlement Sale Proceeds versus Total Loss
 - ... More Investable Assets from "Redirected Gifts", "Excess" Account Values, and Happier Clients







There are other alternatives besides gifting for funding a life insurance policy under an irrevocable trust. These consist primarily of:

- Split-dollar funding.
- Having income-producing assets in the life insurance trust.
- Merging or decanting other trusts that have significant assets or income, such as a remainder trust
 resulting from a successful "Grantor Retained Annuity Trust" (GRAT) that might have been established
 for the primary purpose of being able to provide premium dollars in a tax-efficient manner.



Split-Dollar Loans and Arrangements

Under split-dollar life insurance arrangements, the insured or another family member or entity can make premium payments and consider the payments to be loans or beneficial interest advances. This entitles the contributing party to be repaid at a rate with little to no interest, depending upon the type of split-dollar arrangements selected, when the policy is cashed in or upon the death of the insured. Therefore, many families have family limited partnerships or LLCs.

Alternatively, individuals who will receive split-dollar advance repayments upon the death of an insured or upon the liquidation of a life insurance policy may renegotiate for a higher interest rate to apply with respect to the payments to be received when the policy is cashed in or "matures" upon the death of the insured.

Multi-generational split dollar is the name given to an arrangement whereby a senior family member, or entity owned in large part by a senior family member, advances money to an individual or an irrevocable life insurance trust to pay the premium(s) on a policy owned by a junior family member or a life insurance trust holding life insurance on a junior family member.

The loan can be at the long term Applicable Federal Rate, which is a below fair market value rate, and provide that the advancing party/lender will not be repaid until the policy matures (upon the death of the insured individual).

While the below fair market loan does not constitute a gift under the gift tax laws, the value of the right to be repaid may be worth less than half of the amount advanced, depending upon the life expectancy of the insured. (Internal Revenue Section 7872 and Treasury Regulation 1.7872-15, under the split-dollar rules, indicate that no gift is considered to be made as long as the applicable federal rate is used.)





Split-Dollar Loans and Arrangements

There are many arrangements such as this in place, which essentially put the senior family member into an unfortunate position, specifically from a financial standpoint, because they may not be repaid until the junior family member or trustee dies or voluntarily unwinds the situation, which could be decades in the future.

Taxpayers who still hold taxable estates may consider making split-dollar loans to fund policies for younger family members. Taxpayers who have made these loans and are no longer concerned about the federal estate tax may want to renegotiate to receive the right to call the loan in or the right to increase the interest rate. This way the senior family member can sleep better at night knowing that they can receive payment on the loan well before the death of the junior family member if they need it.





How Much Interest Can Be Charged on Split Dollar and Other Loans?

Including the 5% Guideline:

When setting the interest rate for split-dollar life insurance loans, the Internal Revenue Code establishes that for federal estate tax purposes, the minimum rate must be at least the Applicable Federal Rate (AFR). (IRC § 7872.)

The AFR is published monthly by the IRS and varies depending on whether the loan is short, mid, or long-term. Charging at least the AFR is essential to ensure the loan is not classified as a below-market loan, which would otherwise result in imputed interest and possible gift or compensation tax consequences.

There is no explicit federal maximum interest rate for interfamily loans, the five percent above the applicable federal rate seems to be safe for a gift tax standpoint. (Generally, instruments that mature after five years can bear a maximum interest at 5% above the mid-term applicable Federal Rate. Jerry M. Hesch, Esq. et al., *Interesting Interest Questions: Interest Rates for Intra-Family Transactions*, 36 Tax Mgmt. Est., Gifts, Tr. J. 1, 6 (2011). "Regs. § 1.1274-3(b)(3) states that 'interest on a debt instrument excessive if the interest. . . is clearly greater than [an] arms-length transaction amount." *Id.*)





What Maximum Interest Rate Can Be Used in a Related-Party Loan? (Cont.d)

Assuming that usury laws are complied with, §163(i) provides that a debt instrument with a maturity five years or greater from the date of issue can bear interest, at maximum, at 5% above the mid-term Applicable Federal Rate. This appears to be a safe harbor for federal income tax purposes.

Regs. §1.1274-3(b)(3) states that "interest on a debt instrument is clearly excessive if the interest, in light of the terms of the debt instrument and the creditworthiness of the borrower, is clearly greater than the arm's-length amount of interest that would have been charged in a cash lending transaction between the same two parties." This regulation is far from clear, and uses terms, such as "clearly excessive" and "clearly greater than the arm's-length amount of interest that would have been charged," upon which reasonable minds may easily differ. That being said, as a practical rule, it may be preferable to not stray too far from the prevailing market interest rates that are used in similar type transactions when determining the maximum interest rate that can be applied to a transaction.

Additionally, Regs. §1.707-4(a)(3)(ii) can be used by analogy. It provides a safe harbor maximum interest rate of 150% of the long-term AFR then in effect in the context of preferred returns or guaranteed payments made to a partner of the partnership. (Tax Management Estates, Gifts and Trusts Journal, Vol. 36, No. 2, 3/10/2011, Jerry M. Hesch, Esq., Alan S. Gassman, Esq., Christopher J. Denicolo, Esq., *Interesting Interest Questions: Interest Rates for Intra-Family Transactions.*)

If a trust is the lender, the trustee has a fiduciary duty to act in the best interests of all beneficiaries.

The interest rate should be fair and reasonable, reflecting market conditions and the risk profile of the loan. Excessively high rates could be challenged as unfair or as a breach of fiduciary duty. It is important for the trustee to document the rationale for the chosen rate, taking into account market rates, the trust's investment policy, and the interests of all parties.





What Maximum Interest Rate Can Be Used in a Related-Party Loan? (Cont.d)

Estate planning literature and tax commentary often reference a "safe harbor" for interest rates up to 5% above the AFR. If the stated interest rate is no more than 5% higher than the AFR, the note will generally be valued at its issue price for gift tax purposes. This means that, at or below 5% above the AFR, the loan is considered to have adequate stated interest and is not subject to recharacterization or adverse valuation for gift tax purposes. However, if the interest rate exceeds the AFR by more than 5%, the IRS may recharacterize the loan as a high-yield debt obligation (HYDO), and the excess interest could be treated as disguised principal, potentially leading to adverse tax consequences.

If a trust is the lender, the trustee has a fiduciary duty to act in the best interests of all beneficiaries. The interest rate should be fair and reasonable, reflecting market conditions and the risk profile of the loan. Excessively high rates could be challenged as unfair or as a breach of fiduciary duty. It is important for the trustee to document the rationale for the chosen rate, taking into account market rates, the trust's investment policy, and the interests of all parties.





The following table summarizes the guidelines for setting interest rates on loans:

I.R.C. § 163(j).

| Interest Rate Charged | Tax / Legal Treatment |
|------------------------|--|
| At least AFR | No imputed interest; not treated as a gift; safe from below-market loan rules |
| Up to 5% above AFR | Tax Safe harbor — valued at issue price for gift tax purposes |
| More than 5% above AFR | May be treated as HYDO; excess interest could be disguised principal — adverse gift/tax impact |
| Above state usury cap | Potentially void or unenforceable under state law |





Excluding Policy Cash Value From Estate Inclusion, the Levine Case

The IRS vigorously contests situations where multi-generational split-dollar has been used to generate significant discounts on federal estate tax returns, but the case law has generally been favorable to taxpayers. (See Levine discussion infra.)

The holding in the Tax Court case of *Estate of Marion Levine v. Commissioner* demonstrates that split-dollar arrangements can successfully exclude policy cash values from estate inclusion, but only if structured with strict separation of powers and ownership. (158 T.C. 58 (T.C. 2022)).

In Levine, an Insurance Trust purchased life insurance policies on the lives of decedent's relative and their spouse, which a Revocable Trust owned by the decedent paid \$6.5 million in premiums for under a split-dollar arrangement. (Id. at 74.)

The Insurance Trust assigned the insurance to the Revocable Trust as collateral, and the Insurance Trust agreed to pay the total premiums paid and either the cash-surrender value upon death of the insured or the cash surrender value of the policies when terminated by the Insurance Trust, which ever was greater. (Id.)

The Tax Court ruled in favor of the estate, finding that the properly designed and implemented split-dollar arrangement did not result in the inclusion of the insurance policy's cash value in the donor's gross estate under IRC §§ 2036 or 2038. *Id.* at 96. I.R.C. §§ 2036(a)(2) and 2038 do not require inclusion of the policies' cash-surrender values. The court ruled in favor of deceased's estate because deceased did not have any right, whether by herself or in conjunction with anyone else, to terminate the policies. Only the irrevocable trust had that right. (*Id.*)

The reasons for the court were, first, that there had been no transfer of the insurance policy because the Insurance Trust, which the decedent never owned, always owned the life insurance policy. (*Id.* at 84-86.)

Second, while there was a "transfer" of the \$6.5 million for the premiums, the decedent did not retain an interest in the policies because she did not have immediate rights to the cash-surrender value and could not terminate the policies unilaterally, only the Insurance Trust had that ability. (Id.)

Therefore, the cash surrender value of the policies was not to be included in the gross estate. (Id.)





Repurposing for Buy-Sell Agreements

A policy on an individual, a married couple, or two individuals who were a married couple may be repurposed from paying estate taxes to use in a buy-sell agreement. It could also be used for key person coverage where there is a multiple-owner business or investment company and it would be useful to have an individual's ownership interests purchased in the event of death.

An Irrevocable Life Insurance Trust could become the purchaser of stock on the death of the insured, thus remaining intact and providing a benefit for the beneficiaries of the trust, by:

- Purchasing the stock LLC interests or other rights or assets owned by the insured on the death of the insured or
- Selling or loaning the policy to the other owners so that they can purchase the ownership interests from the insured on the death of the insured or
- Selling or loaning the policy to the other owners so that they can purchase the ownership interests from the insurer on the death of the insured.

The other owners, the entity itself, or an entity taxed as a partnership and owned in some part by the other owners, could either purchase the policy from the life insurance trust (which would no longer thereafter be a life insurance trust) or agree to buy the right to the death benefit to be generated under the life insurance trust by using "reverse split dollar." In this arrangement, the life insurance trust would receive annual amount equal to the PS58 cost, while shareholders cover the difference.

This structure differs from the arrangement in *Levine*, where the split-dollar agreement followed an economic benefit regime but was structured more favorably toward the shareholder, who retained rights to the policy's cash value and sought repayment of its contributions. In contrast, the reverse split-dollar approach gives the employee greater economic interest from the outset, particularly in the cash value and future death benefits. The tax implications of a reverse split dollar approach include annual taxation to the shareholder based on the value of the PS58 costs, which is generally treated as imputed income. Unlike the *Levine* arrangement, the reverse structure may reduce or eliminate the need for repayment or employer recovery, shifting tax burdens and benefits earlier to the shareholder. (See *Levine* 158 T.C. at 85.)





The Connelly Question – Maybe We Now Want a Higher Value Included For Basis Step-Up

Purposes

Connelly Facts:

- Many life insurance buy-sell arrangements are still being reviewed because of the Connelly v. United States case. (See Connelly v. United States, 602 U.S. 257 (2024).)
- In Connelly, the decedent and his brother were sole shareholders in a valuable and closely held corporation. (Id. at 261.)
- The brothers entered into a contract that gave the surviving brother the option to buy the shares of the first brother to die, with the corporation then obligated to repurchase the shares of the first-to-die brother in the event that the surviving brother declined to purchase them. (Id.)
- The agreement stated that an outside appraiser would determine the fair market value of the shares. (Id.)
- The corporation purchased life insurance on the lives of both brothers to ensure that it would have sufficient funds to purchase the shares. (Id.)
- Upon the decedent's death, who owned 77.18% of the company, the decedent's son and brother, rather than using an outside appraisal, independently reached an agreement on the value of the shares at \$3 million. (Id.)
- The life insurance proceeds were then used to purchase the shares. (Id.)





The Connelly Question – Maybe We Now Want a Higher Value Included For Basis Step-Up

Purposes

Connelly Holding and Reasoning:

- The U.S. Supreme Court held that fair market value determined the value of the shares for estate tax purposes and that the life insurance proceeds should not be excluded from the valuation. (*Id.* at 267.)
- The court reasoned that "no real-world buyer or seller would have viewed the redemption obligation as an offsetting liability" because a "share redemption at fair market value would not affect shareholder economic interests." (Id. at 263.)
- The Court stated that the focus of estate evaluation was on the fair market value at the time of the decedent's death, not what it would be valued after death. (Id.)
- Therefore, the total value of the corporation was equal to its \$3.86 million in assets plus the \$3 million in potential life insurance proceeds earmarked for redemption, totaling \$6.86 million. (Id.)
- This meant a willing buyer would have paid up to \$5.3 million for all of the decedent's shares. (Id. at 264.)





The Connelly Question – Maybe We Now Want a Higher Value Included For Basis Step-Up

Purposes

Take Away:

• For this and other reasons, many tax and finical advisors prefer to use a cross-purchase agreement or have the life insurance placed into an entity, taxed as a partnership under the arrangement described in Private Letter Ruling PLR 96-51017. This is to, first; assure that the policy death benefit will not be considered included in the value of the estate of the deceased owner. Second, it will assure that the death benefit does not go into a company that may have liabilities exceeding the value of its assets (to ensure that the death benefit is not lost to creditors). Finally, this enables the purchasing owners to receive an income tax basis in the purchased interests equal to the amount paid, assuming that this is also equal to the fair market value of the ownership interest.





Common Mistakes in Drafting Buy-Sell Agreements

Lack of a clearly defined valuation method

Failure to fund the agreement (e.g., no insurance)

Inadequate coverage of triggering events

Unclear or incomplete buyout terms

Conflicts with wills or operating agreements

Improper use or titling of life insurance

Ignoring tax implications

No plan for involuntary transfers (e.g., divorce, bankruptcy)

Using generic templates not tailored to the business

Failure to review and update the agreement regularly





VALUATION METHODS

FIXED PRICE (REVIEWED PERIODICALLY)

BOOK VALUE OR ADJUSTED BOOK VALUE

FORMULA (E.G., EBITDA MULTIPLE)

INDEPENDENT THIRD-PARTY VALUATION





BENEFITS OF A WELL-STRUCTURED BUY-SELL AGREEMENT

MAINTAINS BUSINESS CONTINUITY AND STABILITY.

REASSURES CLIENTS, EMPLOYEES, AND CREDITORS.

PROVIDES LIQUIDITY FOR THE DEPARTING OWNER OR THEIR FAMILY.

PREVENTS FORCED SALES OR OWNERSHIP BY UNWANTED PARTIES.





KEY TAKEAWAYS

Buy-sell agreements are essential for every closely held business.

They should be customized to the business and reviewed regularly.

Funding, valuation, and trigger event clauses are critical to success.



Cross-Purchase Agreement with Life Insurance

Each owner purchases a policy on every other owner.

Proceeds are used to buy deceased owner's share directly from estate.

Ownership and beneficiary designations are held individually.

Best for businesses with 2–3 owners due to complexity as partners increase.



A Logical Guide to Selecting Buy/Sell Agreement Arrangements-Traditional Choices are Not Always the Best By Alan S. Gassman, J.D., LL.M.

A. Entity Redemption Arrangements. The company owns the life insurance policy and is the beneficiary thereof. Upon receipt of the life insurance proceeds, the company is to use such proceeds to buy out the deceased owner.

Will there be enough money to (A) buy out the deceased owner and (B) have the deceased owner released from any and all guarantees and obligations associated with the business?

- 1. If it is not practical to have the deceased owner released for contractual or other reasons, should the part of the life insurance proceeds that would otherwise be kept by the company as key man insurance be escrowed pending satisfaction of all releases that the deceased owner may have responsibility for.
- 2. How can the deceased owner's family be sure that the monies received from the life insurance policy will actually be used to satisfy contractual buy-out agreements?
- 3. What if the company claims that for some reason the agreement is not enforceable or that there are claims against the deceased owner that offset what would be paid to him or her.
- 4. What if the company has a major creditor claim against it (what if the deceased owner died in a car accident that he or she caused while driving a company vehicle and the company is now being sued by others who died in the accident?)
- 5. What if the company goes into bankruptcy and the family of the deceased owner becomes just another creditor in a bankruptcy proceeding?
- 6. For income tax purposes the remaining shareholders do not get a stepped up basis for the stock purchased. The stock simply becomes treasury stock.





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B. To avoid the above potential problems consider a cross-purchase agreement?

Each owner may own the policy or policies on the other owners. Thus the policy proceeds should be protected from creditors of the company.

Also, each purchasing shareholder will get a tax basis in the purchased stock equal to the purchase price thereof.

- 1. However, policy proceeds will not be protected from creditors of the surviving owner who would receive policy proceeds.
- 2. Also, contractual disputes could result in the surviving owner using the funds for other purposes while litigating over the obligation to pay and becoming insolvent.
- 3. Further if there are more than 2 shareholders, the on the death of one the policies owned on the others would need to be transferred to rebalance between them, thus causing issues under the transfer for value rules. For example, if there are 4 equal shareholders there have to be 4 policies each owned 1/3rd each by each 3 shareholders on the fourth, and if one leaves the company the remaining 3 policies have to be readjusted as to ownership.





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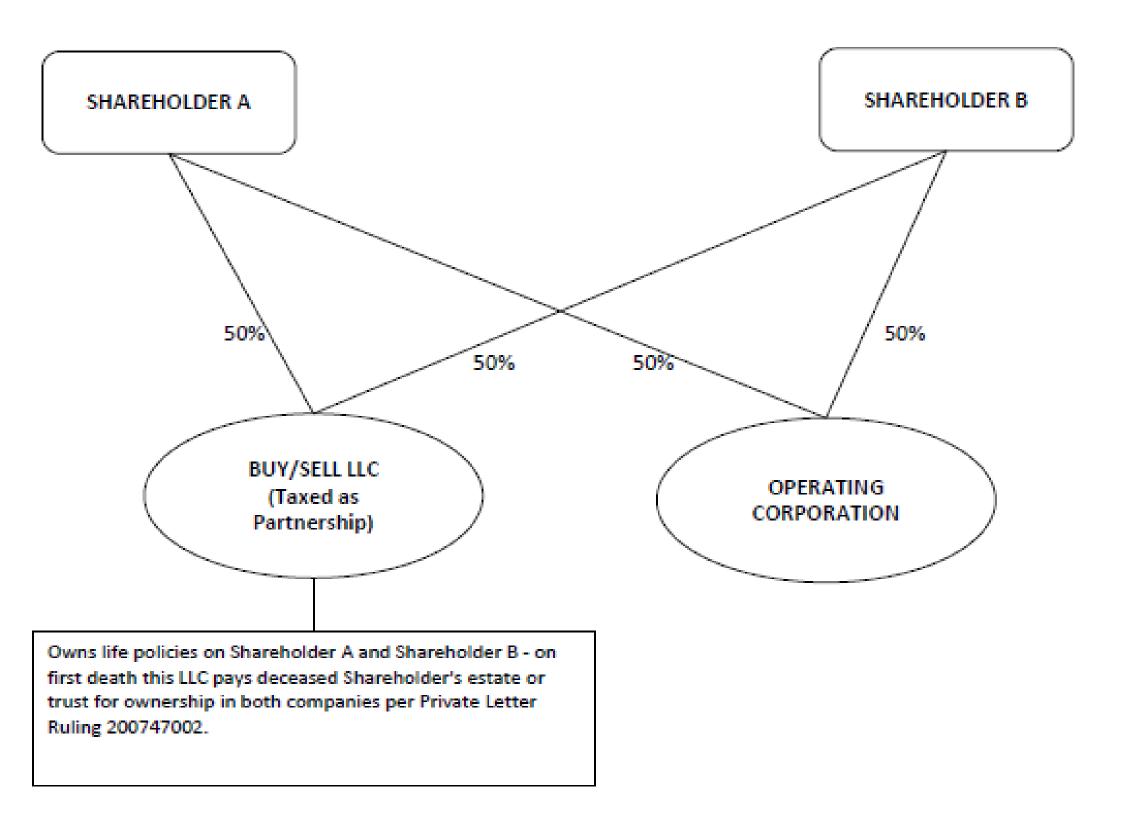
C. Hybrids of the Above:

- 1. Consider a Trusteed Corporate or Cross-Purchase Agreement. Under these arrangements the owner and beneficiary of the policy can be a trust company, a law firm, or another trusted institution as trustee for the benefit of the company in a Trusteed Redemption arrangement, or for the benefit of the other shareholder or shareholders in a Trusteed Cross Purchase arrangement. The trust agreement can require that the policy proceeds be held safely until sale and used solely for redemption or cross-purchase purposes.
- 2. This at least assures the surviving family that the life insurance proceeds will not be absconded with.
- 3. Generally for tax purposes the policy needs to be considered as owned and payable to the company in a redemption arrangement or the surviving owner or owners in a cross-purchase agreement. Could a state court or a bankruptcy court override the trust agreement where there are creditors of the entity in a redemption arrangement or creditors of the remaining shareholders in a cross-purchase arrangement?
- 4. There would be a purchase price tax basis for the other shareholders if the Trustee appropriately characterized as an agent for the other shareholders.





Cross-Purchase Arrangement







Buy-Sell Agreements and Estate Tax Planning

Many buy-sell agreements have provided for the value of ownership interests to be as low as is reasonably possible under the estate tax rules, which require that a value be commensurate with the amount that similarly situated, unrelated parties would pay for an applicable ownership interest pursuant to Internal Revenue Code § 2703, which reads as follows:

(a)General rule

For purposes of this subtitle, the value of any property shall be determined without regard to—

(1) any option, agreement, or other right to acquire or use the property at a price less than the fair market value of the property (without regard to such option, agreement, or right), or

(2) any restriction on the right to sell or use such property.

(b)Exceptions

Subsection (a) shall not apply to any option, agreement, right, or restriction which meets each of the following requirements:

- (1) It is a bona fide business arrangement.
- (2)It is not a device to transfer such property to members of the decedent's family for less than full and adequate consideration in money or money's worth.
- (3) Its terms are comparable to similar arrangements entered into by persons in an arms' length transaction [emphasis added].





Buy-Sell Agreements and Estate Tax Planning

Family members and close friends who have essentially played Russian roulette in order to reduce federal estate tax exposure may wish to revise their agreements and/or agreed values to a higher "fair market value".

When there is no longer an estate tax threat existing, those individuals and companies may want to increase death benefit coverage and key person coverage to reflect the amounts to be paid for the stock or membership interests of a deceased owner without regard for federal estate tax implications, if the applicable owner is well below the estate tax thresholds.





Entity Redemption Agreement with Life Insurance

Business owns life insurance on each owner.

Upon death, the business uses proceeds to redeem the deceased owner's interest.

Simplifies policy administration—one policy per owner.

May have less favorable tax basis outcomes for surviving owners.





Key Person Insurance in Estate and Business Continuity Planning

Safeguarding Value and Stability in Business Transitions



Why Key Person Insurance Matters



The loss of a key executive or owner can cause major disruption.



Revenue can decline sharply during the transition period.



Business value may fall without strong leadership in place.



Helps preserve continuity while estate or succession plans are executed.





How Does Connelly Impact Insurance-Only LLCs

Over the past decade, the Insurance-Only LLC has become a popular vehicle for structuring life insurance-funded buy-sell agreements. *Connelly* clearly impacts Insurance-Only LLCs because the agreement typically requires the deceased member's interest in the Insurance-Only LLC to be redeemed before the death claim is made with the carrier.

It is precisely at this point in the transaction that advisors will need to be creative, and one planning technique that advisors have pointed to is whether it is possible to "specially allocate" the death benefits to the surviving owners' capital accounts so a deceased member's interest is bought out for a value not inclusive of the death proceeds. (Citation *infra*)

(See generally Treas. Reg. § 1.704-1(b). Special allocations in partnership and LLC agreements must have "substantial economic effect," meaning the allocation must reflect the partners' actual economic arrangement and not be solely tax-driven. To satisfy the economic effect prong under Treas. Reg. § 1.704-1(b)(2), (i) capital accounts must be maintained under § 1.704-1(b)(2)(iv), (ii) liquidating distributions must follow positive capital account balances, and (iii) the agreement must include either a deficit restoration obligation (DRO) or a qualified income offset (QIO). The substantiality prong under § 1.704-1(b)(2)(iii)(a) requires a reasonable possibility that the allocation will materially affect partners' dollar returns, independent of tax consequences. For example, in an Insurance-Only LLC, insured members may cross-pay premiums to support economic effect, with special allocations of death benefit proceeds to non-insured surviving members. This can reduce the decedent's ownership value for estate tax purposes while increasing the basis of the survivors. Capital accounts must be carefully tracked. Suppose five equal shareholders (A through E) in an S corporation form an Insurance LLC, each insured for \$2 million. Premium costs differ, with A's premium at \$50,000 and E's at \$20,000. Cross-payments are allocated across members, and if A dies, the \$2 million death benefit is allocated equally among B through E. For the allocation to hold under § 704(b), documentation must reflect the economic burden and benefit consistently and meet all regulatory requirements.)

The special purpose buy-sell insurance LLC has largely started to replace the trusteed buy-sell agreement as the go-to planning technique. The Special Purpose Buy-Sell Insurance LLC (BSILLC) can solve many of the issues with both cross-purchase and entity redemption arrangements.





How Does Connelly Impact Insurance-Only LLCs

For example, entity redemption arrangements may result in the loss of a basis increase for the remaining owners, the exposure of the life insurance policies to the business's creditors, and potential income taxation on the change of ownership of the life insurance policy from the business to the insured at retirement. But the need for a lot of life insurance policies makes the cross-purchase agreement less desirable when there are many owners, which may cause advisors to consider the Insurance-Only LLC. The Insurance-Only LLC is a separate legal entity that owns the life insurance policies on the business owners' lives to fund a separate buy-sell agreement amongst the business owners. The business owners are members of the Insurance-Only LLC, and the centralized ownership of the life insurance policies in the LLC may make the premium payments easier to administer and allocate between the business owners, ensure all the policies are kept in force and that a business owner does not drop the policy insuring another business owner, and assists in paying the life insurance proceeds to a decedent's estate for the purchase of the decedent's ownership interest in the operating business as required by the separate buy-sell agreement.

With the holding in *Connelly*, entity redemption arrangements funded with company owned life insurance will generally result in the value of the company plus a pro-rata portion of the insurance proceeds being included in the deceased's gross estate. This is a change from prior case law that held that a redemption agreement created an obligation that offsets the life insurance proceeds received by a business that is used to redeem a deceased's interest in the business. (See *Blount* and *Cartwright*.)

The planning implications from the Connelly decision as well as some of the many workarounds that advisors have devised are discussed below.





What if the Deceased Business Owner Did Not Have a Taxable Estate?

Shortly after the Connelly decision was announced, some advisors asserted that if a business owner does not have a taxable estate, Connelly does not present a problem.

The inclusion of life insurance proceeds in the business value for estate tax purposes may not result in additional estate taxes for those who do not have taxable estates, but increasing the value of a business for estate tax purposes has other ramifications. There are step-up in basis issues, capital loss issues, and redemption price issues that may arise from the decision in *Connelly*.

Business owners who do not have an estate tax concern still need to be mindful of *Connelly*. Under *Connelly*, the fair market value and thus the estate tax value of the shares includes life insurance proceeds received by the corporation. For example, let's say Michael and Jim equally own MGJM, Inc., which is worth \$10M. MGJM, Inc. purchases two \$5M policies insuring Michael and Jim. A stock redemption agreement states MGJM, Inc. will redeem a deceased shareholder's shares for \$5M. Michael passes away and the corporation receives the \$5M death benefit.

Under Connelly, the fair market value of the corporation is \$15M and the estate's share is \$7.5M. As that is the fair market value, Michael's estate obtains a step-up in basis equal to that value under IRC § 1014(a)(1). But per the terms of the stock redemption agreement, his estate only receives \$5M as the purchase price on the stock redemption. His estate realizes a \$2.5M capital loss on the redemption. Michael's estate should be able to use that capital loss to offset any capital gains the estate may recognize. In the estate's final tax year, unused capital losses may be passed through to the estate beneficiaries.

Redemption agreements may include a price adjustment clause, so if the estate tax value of a business is higher than the purchase price listed in the agreement, the business agrees to pay an additional amount to the seller to cover the shortfall. However, there are many redemption agreements that do not currently have such a clause. Business owners should review their agreements and make adjustments accordingly.





Connelly Can Impact All Estates and Business Owners

Connelly will certainly impact business owners who have taxable estates by increasing the estate tax value of a business for the death benefit received on company owned life insurance. This will further increase the deceased's gross estate. Business owners who do not have a taxable estate based just on the value of the business may be pushed into a taxable estate when the insurance proceeds are added to the business value. Note that if a decedent's business interest passes to a U.S. citizen spouse, the estate can claim the unlimited marital estate tax deduction, however, whatever is left at the time of the surviving spouse's death would be included in his or her taxable estate.





Connelly's Impact on Basis Consistency

Regarding step-up in basis rules, for taxable estates, "basis consistency" rules also come into play. IRC § 1014(f) states the basis of property acquired from a decedent may not exceed its final value for estate tax purposes or, if not finally determined, the value of that property as reported on a statement made under IRC § 6035. The concept of "basis consistency" is that the value of assets reported on a Form 706 becomes the asset's basis in the hands of its new owner. An executor of an estate that is required to file Form 706 is required to file Form 8971 with attached Schedule(s) A and must also provide each beneficiary listed on Form 8971 with that beneficiary's Schedule A. Form 8971 requires the following information be provided to beneficiaries:

A description of the property acquired from the decedent;

Whether the asset increased estate tax liability;

The valuation date; and

The estate tax value in U.S. dollars.

Form 8971 isn't required when:

The gross estate plus adjusted taxable gifts is less than the basic exclusion amount;

The estate tax return is filed solely to make an allocation or election respecting the generation-skipping transfer tax; or

The estate tax return is filed solely to elect portability of the deceased spousal exclusion amount.

Under *Connelly*, the fair market value of a decedent's business interest would include a pro-rata portion of the insurance proceeds received by the business. That fair market value would be reported on the estate tax return and Form 8971 (unless Form 8971 is not required as stated above). That fair market value would provide the estate/heirs with a stepped-up basis in the business. If the buyout price is less than the stepped-up basis, the estate/heirs have a loss on the sale. This step-up in basis and loss issue is present in both taxable and non-taxable estates.



Redemption Price Issues

Business appraisers have historically relied on *Blount* and *Cartwright* to exclude life insurance proceeds from a business valuation, but that now contradicts *Connelly* so appraisers may include the death benefit in the business valuation going forward. The result is an underfunded arrangement.

For example, MGJM, Inc.'s stock redemption agreement states the purchase price is fair market value as determined at the time of death. MGJM, Inc. was worth \$10M before the death benefit but is worth \$15M after the death benefit. That would result in a \$7.5M value for Michael's estate's shares and that would be the purchase price per the stock redemption agreement. However, MGJM, Inc. only received \$5M in death benefits, leaving it liable to pay \$2.5M using other corporate assets and/or a promissory note.

A company could have an entity redemption agreement but keep the life insurance outside the business. Death benefits received by the owners outside of the business could be used by the owners to make a capital contribution or loan to the business so it can redeem the deceased's ownership interest. (See Connelly supra. Connelly raises a larger issue, which is why use redemption-type buy-sell agreements in the first place? Stock redemptions themselves result in "wasted basis" because the surviving shareholders don't purchase the decedent's shares, the corporation does, so the surviving shareholders' cost basis in their shares isn't increased after the redemption. For S corporations, the shareholders may obtain an increase in basis only because of the corporation's receipt of life insurance proceeds. Shareholders of C corporations would not obtain an increase in basis in their shares. In addition, with life insurance funded redemption plans, the insurance is owned by the business, so judgment creditors of the business can attach the policy's cash surrender value and the death proceeds because there is no creditor exemption for business-owned life insurance.)





Move the Business Interest to Trusts

Another *Connelly* work-around is to move the business interests into irrevocable trusts as there should be no estate inclusion if the interests in the operating business are owned outside of a decedent's estate. But this approach has complexities. First, there could be significant gift tax exposure if the valuations of the business interests are high. Second, from an administrative standpoint, clients may find it impractical to have their business interests owned in trust.





Creating Multiple LLCs

Creating multiple LLCs where each policy is owned in a separate LLC so the decedent does not have an ownership interest in the LLC that owns the policy on the decedent's life is another option some advisors have considered. That said, some clients may look at this and conclude that the expense of creating and maintaining multiple LLCs is simply not worth it.





Resurgence of the Trusteed Buy-Sell Approach?

Trusteed buy-sell agreements have a number of features that on first blush make them attractive, the most prominent of which is the fact that the trustee is required to purchase only one policy per business owner. In addition, centralized management of a large block of policies is often preferable to each insured owning and maintaining multiple policies on multiple insureds. Finally, there may be a degree of creditor protection afforded to the insureds from trust-owned life insurance where a spendthrift provision is utilized.

Trusteed buy-sell agreements come in two flavors: business-sponsored where the entity establishes the trust for the benefit of the business owners, and individual-sponsored where the insured/business owners establish the trust. Note that entity-sponsored trusts can pose difficult income tax issues.

Perhaps the most troubling aspect associated with trusteed buy-sell agreements for corporations is the fact that the transfer-for-value (TFV) issue at the first death has forced planners to either find a partnership exception to the transfer for value rule, or simply unwind the agreement after the first owner's death and start over again. Although there is no physical transfer of the policies owned by the trustee at the first death, the deceased owner's interest in the policies on the other owners' lives shifts to the surviving owners pro rata, and most advisors think this creates a TFV problem. In fact, some planners refuse to utilize the arrangement if they are unable to find or create a partnership exception to the TFV rule.

The degree of control trust beneficiaries have over the trustee can impact the estate tax inclusion/exclusion of the life insurance proceeds. In cases where the trustee looks too "directed" by the beneficiaries, the Service has found the proceeds to be estate tax includible. On the other hand, where the trustee is truly independent, the Service has ruled against inclusion.





Ownership and Beneficiary Designation

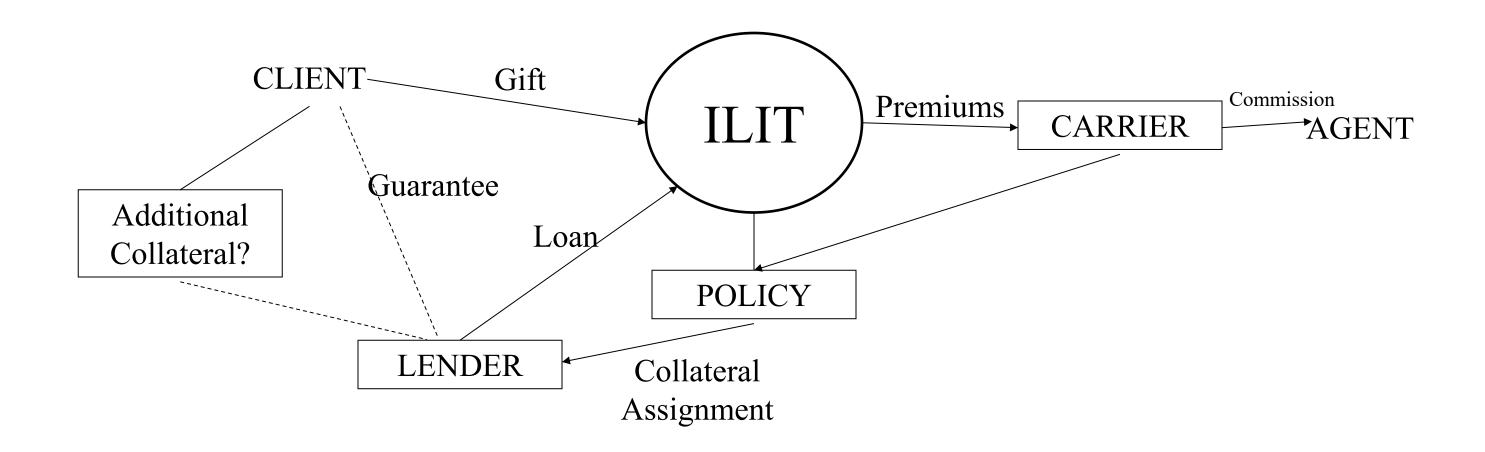
Traditionally, it was best to have an irrevocable life insurance policy owned by the wealthier or primary earning spouse, or by an Irrevocable Life Insurance Trust established and funded by that spouse for the benefit of any surviving spouse and descendants.

If the life insurance policy was held individually, then it would commonly be payable to a credit shelter trust established under the last will and testament or revocable trust of the insured spouse to assure that the policy proceeds would be protected from federal estate tax, creditor claims, and possible divorce scenarios that might be experienced by the surviving spouse. Alternatively, the policy could be paid outright to the surviving spouse, and there would be no estate tax protection or creditor protection once the spouse has received the policy proceeds or built-in subsequent marriage/divorce protection. It may now be more popular to have life insurance proceeds under policies owned individually by the insured payable to a Qualified Terminable Interest Property Trust (QTIP) marital deduction trust. This way, the assets in the trust on the death of the surviving spouse may receive a new fair market value income tax basis if the surviving spouse is not expected to be estate taxable upon his or her death. Many considerations apply with respect to what kind of trust should receive life insurance proceeds upon the death of an insured.





Premium Financing is as Simple as it Looks



The policy may be cashed in with amounts of value exceeding the loan owned by the ILIT or will pay loan and provide remaining death benefit to ILIT on death of client.



Transfer for Value Rules

The "transfer for value rules" under Internal Revenue Code Section 101 can be very treacherous. A transfer for value of an insurance policy will cause the death benefit of the policy to be subject to federal income tax on the death of the insured. After a violation of the transfer for value rules, a policy may be cleansed by making a transfer of the policy to the insured. Exceptions to the transfer for value rules may be narrowly construed by the IRS, but may include a transfer of the policy to the person whose life is insured, to a joint ownership policy by the persons insured under a second-to-die policy, or when there is a transfer to a person or entity who is a partner in a partnership with the insured.





The most pertinent part of Section 101 of the Internal Revenue Code reads as follows:

- (a) Proceeds of life insurance contracts payable by reason of death
- (1) General rule

Except as otherwise provided in paragraphs (2) and (3), subsection (d), subsection (f), and subsection (j), gross income does not include amounts received (whether in a single sum or otherwise) under a life insurance contract, if such amounts are paid by reason of the death of the insured.

(2) Transfer for valuable consideration

In the case of a transfer for a valuable consideration, by assignment or otherwise, of a life insurance contract or any interest therein, the amount excluded from gross income by paragraph (1) shall not exceed an amount equal to the sum of the actual value of such consideration and the premiums and other amounts subsequently paid by the transferee. The preceding sentence shall not apply in the case of such a transfer—

- (A) if such contract or interest therein has a basis for determining gain or loss in the hands of a transferee determined in whole or in part by reference to such basis of such contract or interest therein in the hands of the transferor, or
- (B) if such transfer is to the insured, to a partner of the insured, to a partnership in which the insured is a partner, or to a corporation in which the insured is a shareholder or officer.

The term "other amounts" in the first sentence of this paragraph includes interest paid or accrued by the transferee on indebtedness with respect to such contract or any interest therein if such interest paid or accrued is not allowable as a deduction by reason of section 264(a)(4).

IRC § 101.





Transfer for Value Rules

Sale of a Life Insurance Policy

Some life insurance policies can be sold for significantly more than the cash value. The viatical industry is active and thousands of taxpayers sell life insurance policies to investors every year. Taxpayers will generally have to pay income tax when a policy is sold for more than the "investment in the policy" amount. Unfortunately, many tax advisors are not aware or intimately familiar with how "the tax basis" of a life insurance policy is calculated.

The term of art under the Internal Revenue Code is the "investment in the contract", which is usually the exact amount of premiums that have been paid for a permanent life insurance policy, subject to the following primary rules:

The investment in the contract is generally the total premiums or consideration actually paid, reduced by any previously excluded amounts. (IRC § 72 (c)(1).)

To qualify as life insurance for tax purposes, a policy must meet certain statutory standards; if it fails, the policyholder must report as income the increase in surrender value plus the cost of insurance, minus premiums paid that year. (IRC § 7702(g); 7702(a).)

For policies sold after 2009, only the portion of premiums not attributable to the cost of insurance counts toward the investment in the contract. (*Annuities; Certain Proceeds of Endowment and Life Insurance Contracts*, Rev. Rul. 2009-13 at 8.)

Premiums paid via policy loans or dividends typically do not count unless repaid with out-of-pocket funds. In a transfer, the recipient's basis includes the amount paid to acquire the policy plus any premiums paid thereafter. (26 CFR §1.101-1(b)(1).)





Policy Withdrawals, Loans, and Taxation

Withdrawals of up to basis (total premiums paid – also known as the policy investment in the contract) are tax-free.

Loans taken from a life insurance policy can also be tax-free as marked from the policy if properly structured, but if the policy lapses or is surrendered with a loan outstanding, the loan is treated as a taxable distribution to the extent of gain. The owner may therefore withdraw an amount up to the total premiums paid, income tax free, and may borrow monies from the policy without triggering income tax as long as the loan is satisfied by the death proceeds or is repaid before then

If, for example, Mrs. Thompson pays \$400,000 in premiums, she can withdraw \$400,000 tax-free. Then, Mrs. Thompson borrows \$100,000 from the policy. Mrs. Thompson passes away and the death benefit repays the loan. Income tax is not owed in this situation.

An alternative is to borrow from a bank or other lender and pledge the policy as collateral. This will not trigger income tax unless the policy is a MEC.

Policy Exchanges and Types of Policies

The exchange of one life insurance policy for another should be carefully considered because there will typically be surrender charges or loss of cash value depending upon the terms and nature of the policy being exchanged. Policy exchanges can also trigger unintended financial consequences, including loss of guarantees, new contestability periods, and higher costs. The compensation to be received by an individual or agency recommending an exchange may make the exchange important to the agent or carrier, but not quite as beneficial to the person or Irrevocable Life Insurance Trust making the exchange. There are many different kinds of life insurance policies that may be considered when an individual or individuals are procuring a new policy or exchanging for a substitute policy. One such example is the private placement life insurance policies, which may have lower costs and higher and more flexibility than conventional policies.





The exchange of one life insurance policy for another should be carefully considered for several reasons, including the fact that there may be significant surrender charges (a.k.a. contingent deferred sales charges) on the "premature" termination of the inforce policy triggering a loss of cash value depending upon the age of the inforce policy, the number of years that surrender charges apply (e.g., between 0 years for policies with no surrender charges, to 10 +/- years in most policies, to 20 or 25 years in some policies), terms and nature of the policy being exchanged and sales and potential surrender charges that will apply to a replacement property.

In addition, an exchange of one life insurance policy for another policy issued by a different insurer almost always triggers additional State Premium Taxes (of 2.35% on average but can be lower depending on the applicable State of jurisdiction, Federal DAC Taxes of 1.50%), and Sales Loads of between 0% on no-load policies and as much as 30%. In that the policy owner has already paid State Premium Taxes, Federal DAC Taxes, and Sales Loads on the inforce policy, incurring these costs again on the cash surrender values of the inforce policy needs to be justified. For instance, the cost of insurance charges (COIs), fixed administration expenses (FAEs) and account-value-based fees (e.g., VUL M&E) in the new policy may be significantly less than those costs in the enforced policy, so that incurring premium taxes and new sales and surrender charges may be justified.

However, extra care is needed when considering whether cost savings in a new policy justifies incurring premium loads again and/or triggering a surrender charge because current regulations in most states permit insurers to "quote" low illustrated premiums, giving the appearance of low-costs, while instead charging high-costs, without disclosing either those high costs, nor the risks of future "premium calls" to cover those high costs.





As such, considering an exchange of one life insurance policy for another policy must include analysis of year-by-year cost disclosures in both policies. Unfortunately, regulations in most states don't require such disclosures, so year-by-year cost disclosures typically must be requested.

Policy exchanges can also trigger unintended financial consequences, including loss of guarantees, new contestability periods, and higher costs. The compensation to be received by an individual or agency recommending an exchange may make the exchange important to the agent or carrier, but not quite as beneficial to the person or Irrevocable Life Insurance Trust making the exchange. There are many different kinds of life insurance policies that may be considered when an individual or individuals are procuring a new policy or exchanging for a substitute policy.

One example is the private placement of life insurance policies, which may have lower costs and more flexibility. An advantage of the tax-free exchange statute is that a policy with no long term care benefits may be exchanged income tax-free for a policy that may permit a large portion, or even more than the cash value of the policy to be used for long term care expenses incurred by the insured.

The question of whether such a policy is more efficient or effective than a traditional monthly or annual premium long-term care contract can be a complicated mathematical exercise, but the ability to have "tax-free" income within a life insurance policy, purchase long term care coverage that would otherwise not be tax deductible is certainly a factor to be considered.





Current regulations in most states permit agents, brokers and insurers to "quote" low premiums, giving the appearance of low costs, whilie instead actually charging HIGH costs, withOUT disclosing either those HIGH costs, nor the HIGHer "bait-and-switch" risks of additional "premium calls" in the future to cover those HIGH costs and/or TOTAL loss due to policy lapse.

Decision-Support in the Client's Best Interest

- ▶ Do NOT compare HYPOTHETICAL premiums, cash values or death benefits as decision-support for 1035-Exchanges
- ▶ Do NOT accept the rate of return shown in illustrations withOUT independent verification
- ▶ Do NOT presume that exchanges permissible under NAIC Illustrations Model Regulations are in your Client's Best Interest
- DO compare internal policy costs being charged in the inforce policy to internal policy costs to be charged in the proposed policy
- ▶ DO consider whether the rate of return required to achieve illustrated expectations is consistent with the client's risk tolerance
- ▶ If costs savings in a proposed policy are greater than any surrender charge (i.e., contingent deferred sales charge) in the inforce policy, and the rate of return required to achieve illustrated expectations is consistent with historical returns for the asset allocation corresponding to the client's risk tolerance, then DO proceed with the 1035-Exchange





Jurisdictions providing Clients' Best Interest Rules protections:

- New York Regulation 187
- California Senate Bill #263 (defeated for the time being)
- SEC RegBI for Variable Products
- NAIC Model #275 for Annuities (sort of)

In all other jurisdictions/situations, fiduciary advisors are the only party responsible for ensuring that:

- 1. Costs are justified relative to peer-group alternatives,
- 2. Performance requirements are reasonable relative to asset-class benchmarks, and
- 3. Risks are appropriate relative to client risk tolerance.





Policy Conversion and Exchange

Many life insurance policies are sold as savings vehicles, and the insured may use the cash value if and when needed by (1) borrowing on a short-term basis, (2) withdrawing up to the amount of premiums paid in tax-free on a long-term basis, or (3) pledging the policy as collateral for a loan.

Cashing a policy in or reducing the death benefit can result in financial penalties and/or surrender charges that should be navigated with caution after receiving multiple illustrations that may show the different alternatives available to a policyholder. Many times, it is best to hire an independent consultant who has expertise in the complicated calculations and contractual terms that apply within a life insurance policy.

Either way, independent benchmarking of costs and performance may be the easiest way to verify that product recommendations are in the Client's Best Interests. For instance, investment recommendations are routinely verified using independent research like Morningstar or benchmarking against relevant asset-class indexes like the S&P500. Likewise, life insurance product recommendations can and arguably should be benchmarked and verified using independent research and analysis, such as which can be provided by Veralytic or possibly by an independent fee for service or hourly paid insurance consultants.





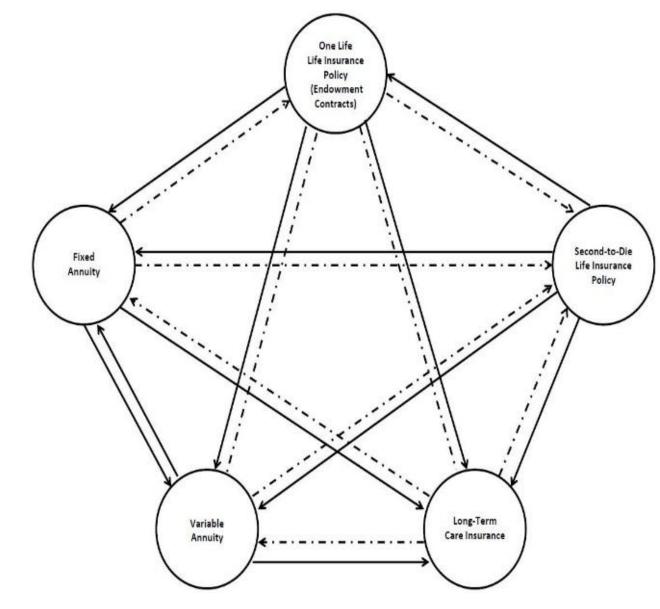
1035 Exchanges

The chart pictured provides a graphic representation of which financial products can be exchanged on a tax-free or tax-deferred basis under Section 1035. As indicated by the chart, Section 1035 allows for a life insurance contract to be exchanged into any of the other listed contracts (i.e. other life insurance policies, endowment contracts, annuity contracts, or long-term care insurance contracts). However, a life insurance policy on one life cannot be exchanged for a life insurance policy that pays on the death of the survivor of two individuals (a second-to-die life insurance policy). Furthermore, endowment contracts may only be exchanged for other endowment contracts, annuities, or long-term care insurance contracts. Long-term care contracts are the most restricted, in that they can only be exchanged for other long-term care contracts. Some variable annuity products provide that minimum annual payments may be doubled if the annuitant would qualify for long-term care benefits. These annuities presumably can be exchanged for other annuities under Section 1035, and the benefit is very limited if all payments under the contract reduce the actual cash value of the contract.

The straight lines in the chart indicate that tax-free exchange treatment under Section 1035 is permitted, while the dotted lines indicate that tax-free exchanges are not available under Section 1035.

Treasury Regulation 1.1035-1 provides that Section 1035 will not apply in situations where the contract or policies that are exchanged do not involve the same insured or obligee. However, Section 1035 allows for the exchange of multiple contracts, meaning that two life insurance policies may be exchanged for one annuity contract, or one annuity contract may be exchanged for two annuity contracts.

Finally, the IRS released Rev. Proc. 2011-38, which provided that, so long as withdrawals are not received from either contract for 180 days following a partial exchange, then the partial exchange will qualify as a tax free 1035 exchange. It reduced the 12-month period that was espoused by the IRS in Rev. Proc. 2008-24 to 180 days, and eliminated the requirement that an exception under Section 72(q)(2) must be met to obtain Section 1035 tax-free treatment. The Rev. Proc. established that a partial exchange of annuity contracts will be tax-free under Section 1035 or "the Service will apply general tax principles to determine the substance of the transfer and, therefore, its tax treatment." Further, the original contract and the new contract are not aggregated after the 180 day period, notwithstanding whether they are issued by the same carrier.







1035 Exchanges - Caution

Current regulations in most states permit agents, brokers and insurers to "quote" low premiums, giving the appearance of low costs, whilie instead actually charging HIGH costs, withOUT disclosing either those HIGH costs, nor the HIGHer "bait-and-switch" risks of additional "premium calls" in the future to cover those HIGH costs and/or TOTAL loss due to policy lapse.

Decision-Support in the Client's Best Interest

- ▶ Do NOT compare HYPOTHETICAL premiums, cash values or death benefits as decision-support for 1035-Exchanges
- ▶ Do NOT accept the rate of return shown in illustrations withOUT independent verification
- ▶ Do NOT presume that exchanges permissible under NAIC Illustrations Model Regulations are in your Client's Best Interest
- DO compare internal policy costs being charged in the inforce policy to internal policy costs to be charged in the proposed policy
- ▶ DO consider whether the rate of return required to achieve illustrated expectations is consistent with the client's risk tolerance
- If costs savings in a proposed policy are greater than any surrender charge (i.e., contingent deferred sales charge) in the inforce policy, and the rate of return required to achieve illustrated expectations is consistent with historical returns for the asset allocation corresponding to the client's risk tolerance, then DO proceed with the 1035-Exchange







Existing Life Insurance Review

- 1. Request inforce ledgers to include year-by-year cost disclosures and performance requirements, premium history, and copies of existing policies for permanent coverage.
- 2. Term insurance policies and a carrier printout confirming ownership and beneficiary designation will also be valuable.
- 3. Prior policies will have application information attached, which includes full application and medical history information that can be used and updated for subsequent applications.
- 4. Controversial have inforce ledger numbers placed on spreadsheets to show historical and expected rate of returns.
 - a. At same time consider requesting the following for permanent policies:
 - i. Inforce Ledger showing reduction of death benefit to minimum corridor amount, and separately to MEC amount for permanent policies, and alternatively showing maximizing death benefit if increase is possible.
 - ii. Confirmation of any payment requirements that must be maintained to keep guarantees or other policy features in place.
 - iii. Are there existing riders that can be added or switched off and costs thereof.
 - iv. Veralytic cost/performance benchmarking. or other report on the carrier and product.





Determining Basis ("Investment in the Contract") for Life Insurance Policies

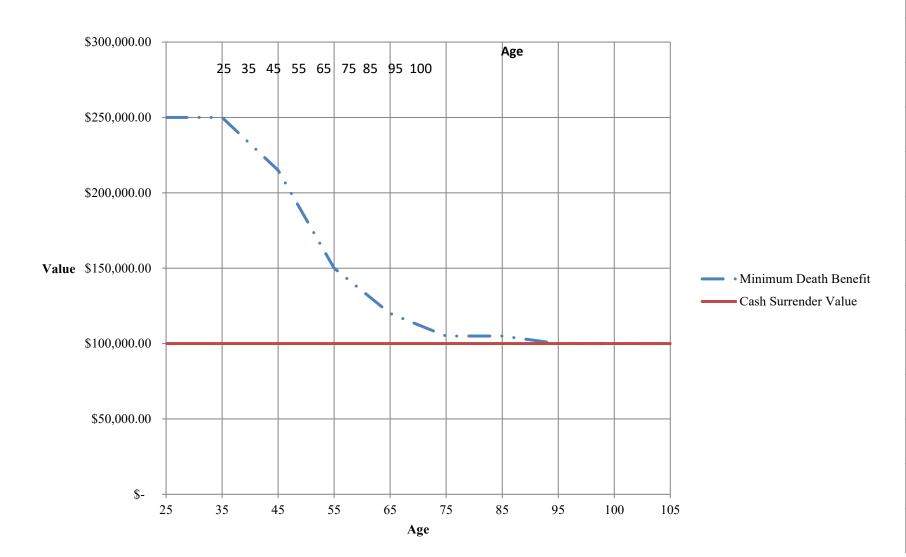
- Investment in the contract or basis is:
 - > (1) the aggregate amount of premiums or other consideration paid for the contract LESS
 - > (2) the aggregate amount received or credited under the contract that is excludable from gross income
- Payments not included in calculating the amount paid for the contract:
 - > Premium payments for (1) disability income, (2) double indemnity provisions, and (3) disability waiver provisions.
 - > Interest payments on policy loans
- What else reduces basis?
 - > Policy Dividends received in cash
 - > Dividends used to purchase policy riders not integral to the insurance policy (e.g. disability income, disability waiver provisions, accidental death insurance, term insurance riders)
 - > <u>Dividends used to pay policy premiums</u>
 - > Dividends used to pay interest on policy loans





Tax Talk

Minimum Corridor Test Illustration \$100,000 Cash Surrender Value Minimum Death Benefit



| Insured's Age | Percentage |
|---------------|------------|
| 40 or less | 250% |
| 45 | 215% |
| 50 | 185% |
| 55 | 150% |
| 60 | 130% |
| 65 | 120% |
| 70 | 115% |
| 75 | 105% |
| 80 | 105% |
| 85 | 105% |
| 90 | 105% |
| 95 or more | 100% |





Policy Conversion and Exchange

Carryover Basis Applied to Term Conversion

The Tax Cuts and Jobs Act amended IRC § 1016(a) to state there is no basis adjustment for mortality, expense, or other reasonable charges incurred under an annuity or life insurance contract. (Rev. Rul. 2020-5 amended Rev. Rul. 2009-13 and Rev. Rul. 2009-14 for the IRC § 1016 amendment.)

Therefore, an insured has basis in his term life insurance policy equal to the cumulative premiums paid.

Historically, the view was that an insured who was issued a term life insurance policy on his life had to reduce his cost basis for the cost of insurance and his basis was only the unearned premium because of the holding in Rev. Rul. 2009-13. However, IRC § 1016(a)(1)(B) and Rev. Rul. 2020-5 should put to rest the notion that an insured who takes out an insurance policy on his life must reduce his policy basis for the cost of insurance for purposes of selling the policy. The open question is whether a term conversion can provide carryover of the term policy's basis into the new permanent policy.

IRC § 1035 allows for tax-deferred exchanges of life insurance policies and provides for carryover basis into the new life insurance policy. However, insurance carriers generally will not process an exchange of a term life insurance policy for another life insurance policy as a 1035 exchange, therefore, the basis in the term life insurance policy is lost. Carriers also generally take the view that a term life insurance policy's basis will not carryover to a new policy in a term conversion. But, given that an insured's basis in his term life insurance policy equals the premiums paid and that a term conversion is essentially the 'exchange' of a term policy for a new permanent policy, should a term conversion provide the insured with carryover basis?





Varieties of Life Insurance Policies Distinguishing Characteristics

| | Term Life | Guaranteed Universal Life (GUL) | Whole Life (WL) | Current Assumption Universal Life (CAUL) | (Equity) Index Universal Life (IUL) | Variable Universal Life (VUL) | |
|-----------------------------------|---|---|---|---|--|----------------------------------|--|
| Distinguishing Characteristics | | Premium & death benefit guaranteed for a specified period with the flexibility to change coverage duration and/or death benefit for a corresponding change in the guaranteed premium. | | sufficent to cover cost Account Values are credited with interest at a | performance from an equity index (e.g., S&P500) EXCLUDING dividends subject to a | | |
| Death Benefit | Face Amount | Face Amount | Face Amount + Paid Up Additions (PUAs) if Dividends are used to buy PUAs & PUAs not used to | | Option A: Face Amount Option B: Face Amount + Policy Account Value | | |
| 1 5 1 | 1, 5, 10, 15, 20 or 30 | Guaranteed but | pay premuims. Dependent on amount & | Option C: Fa | ace Amount + Cumulative Pr | remiums Paid | |
| Coverage Duration | | dependent on the amount | - | Dependent on the sufficiency of policy account values needed to cover cost insurance (COI) charges and policy expenses. | | | |
| Premiums | Fixed & guaranteed for the initial coverage duration. | Fixed & guaranteed until changed by policyowner. | Fixed in amount, but not in the number of years. | Flexible, but must be sufficient to cover COIs & policy expenses over the intended coverage duration. | | | |







Varieties of Life Insurance Policies Distinguishing Characteristics

| | Term Life | Guaranteed Universal Life (GUL) | Whole Life (WL) | Current Assumption Universal Life (CAUL) | (Equity) Index Universal Life (IUL) | Variable Universal Life (VUL) |
|--|-----------|---|---|--|--|---|
| "Premium Call" Risk | None | None, provided premiums are paid when due. | Moderate or Higher if premiums paid by automatic premium loans (APL). | Moderate | Higher | Depends on cash value asset allocation. |
| Cash Value | None | None or nominal. | Guaranteed to equal the Face Amount at policy maturity plus Dividends used to buy PUAs. | | remiums - COIs & Expenses Ilue = Account Value - Surre | |
| Invested Assets Underlying Policy Account Values | N/A | High-grade bonds & gov't- backed mortgages. | High-grade bonds & gov't- backed mortgages. | High-grade bonds & gov't- backed mortgages. | High-grade bonds & gov't- backed mortgages. | Self-directed from among a familly of mutual-fund-like Separate Accounts. |
| Crediting/Earnings Rates | N/A | N/A | Based on performance of the insurer's General Account over the longterm as declared annually to be generally commensurate with prevailing long(er)-term interest rates. | Based on performance of the insurer's General Account over the longterm as periodically declared to be generally commensurate with prevailing mid-term interest rates. | Based on the performance of an equity index (e.g., S&P500) EXCLUDING dividends subject to a max cap, a participation rate, a spread and/or a minimum guaranteed rate (e.g., 0% - 2%) | Based on the gains or loses in the selected mutual-fund-like Separate Accounts. |
| Can Borrow Against Cash Value | N/A | May lose death benefit and/or premium guarantees. | Yes | Yes | | 50%; Subject to Regulation U |
| Policy Loan Interest Rate/Spread (i.e., net cost of borrowing) | N/A | N/A | 6%-8% or less if "direct recognition" type product. | 0%-2% | 0%-2% | 0%-2% |







Varieties of Life Insurance Policies Distinguishing Characteristics

| | Term Life | Guaranteed Universal Life (GUL) | Whole Life (WL) | Current Assumption Universal Life (CAUL) | (Equity) Index Universal Life (IUL) | Variable Universal Life (VUL) | | |
|---|----------------------|--|--|---|--|--|--|--|
| Cash Value at Risk if Insurer Fails | N/A | Yes | Yes | Yes | Yes | No | | |
| Death Benefit at Risk if Insurer Fails | Yes | Yes | Yes | Yes | Yes | Yes | | |
| Can be Sold Without Series 6 License | Yes | Yes | Maybe | Yes | Yes | No | | |
| Commission Concessions | No | Sometimes | Yes | Yes | Yes | Yes | | |
| Life Settlement | Yes, if convertible. | Yes | Maybe | Yes | Yes | Yes, but with only through B/Ds supervised by FINRA. | | |
| Regulated By | State | State | State | State | State | FINRA and State | | |
| Common Riders | | Maturity Extention Rider (MER) to prevent loss of coverage and/or taxable gain otherwise trigged between age 95 - 100. | | | | | | |
| | N/A | Accelerated Death Benefit (ADB) rider for terminal illness (i.e., life expectancy of 6-12 months). | | | | | | |
| | | Long-Term-Care (LTC) or Chronic Illness Riders (e.g., for loss of 2 or more Activities of Daily Living or Cognative Impairment). | | | | | | |
| | | N/A | Over-Loan Protection (OLP) Rider to prevent policy loans from causing policy lapse and the corresponding phanton-taxable-income on the "forgiveness" of accumulated policy loans and accumulated interest. | | | | | |







Varieties of Life Insurance Policies

The primary varieties of life insurance are **term** and **permanent** policies.

Term life insurance policies are sold to provide a death benefit for a set number of years based upon preset premiums. Most term policies provide a stable death benefit for 10, 20, or 30 years, and after the stated term the premiums become very high and basically unaffordable. Most term policies can be converted into permanent policies based upon pricing that reflects the assumption that anyone who would convert a term policy must have health issues. Nevertheless, when a term policyholder has a medical condition or circumstance that significantly reduces life expectancy, converting the term policy to a permanent policy can result in an economic windfall to the family. Many term policies have convertibility option periods that expire well before the term policy premiums increase.

It is best to calendar the convertibility option dates and to seriously consider whether to replace the term policy or convert it before the convertibility option expires.

Permanent life insurance policies are designed to provide a death benefit up through some age beyond life expectancy, such as 99, 103, or 123. For an additional cost, this coverage duration can be guaranteed. For obvious reasons, the premiums needed to cover the costs of coverage beyond life expectancy (which increases the likelihood of the insurance paying a death claim) are significantly higher than the premiums that would apply under the term life insurance policy (where insurers know by experience they will pay less than half of all death claims).

In addition, almost all permanent policies have open "cash value" that builds up during the life of the policy in order to generate internal dividends, interest or investment earnings that can be reinvested or used to pay for the death benefit. The asset classes into which these cash values are invested is a distinguishing characteristic of the different types of permanent policies. For instance, cash values of whole life and traditional universal life are required by regulation to be allocated predominantly to high-grade bonds and government-backed mortgages, from which a fixed-income-type rate of return is reasonable to expect.





Varieties of Life Insurance Policies, Cont'd

Equity-indexed universal life are also required by regulation to be allocated predominantly to high-grade bonds and government-backed mortgages, but the interest from those bonds and mortgages can be allocated to the purchase of options on an equity-index like the S&P500, so that the rate of return is reasonable to expect is somewhat greater-than fixed-income-type asset classes, but could be less than fixed-income-type returns if those options expire out-of-the-money.

Variable universal life policies permit allocation of account values to a family of mutual-fund-like Separate Accounts, typically for a wide range of asset classes. See Distinguishing Characteristics Matix courtesy of Veralytic for more distinguishing characteristics for each product type.

A MEC is a form of life insurance policy that does not have all the tax benefits of a non-MEC policy, but many have a lower death benefit, and therefore lower internal costs, and higher rates of return. The primary difference between a MEC and a non-MEC is that any withdrawal from a MEC during the lifetime of the insured will carry out taxable income to the extent of appreciation within the policy, and any loan from the policy, and interest thereon not paid in cash, will be considered to be a taxable withdrawal.

Many families have life insurance policies that they will never need to withdraw from during the lifetime of the insured. Such policies might be "skinnied down" by reducing the death benefit, which reduces cost of insurance charges, and in turn increases the cash value growth to make the policy a more economically effective savings vehicle, notwithstanding that the ability to make tax withdrawals or loans would no longer exist. As mentioned earlier, unlike a non-MEC, withdraws or loans against a MEC are taxable income on a worst first basis and come with early withdrawal penalties based upon 10% of the income withdrawn (worst first) if the policy owner is under the age of 59 ½.





Varieties of Life Insurance Policies, Cont'd)

The owner of a policy may wish to gift it to a lower bracket taxpayer or a trust that is taxed at the bracket of a lower bracket taxpayer to reduce the income tax incurred in the event of a partial or full liquidation of a policy or the sale thereof. If a MEC is pledged as collateral then the income of the MEC is considered to be transferred to the policy owner. (See Investopedia. (n.d.). Modified endowment contract (MEC). In Investopedia. Retrieved July 15, 2025, from https://www.investopedia.com/terms/m/modified-endowment-contract.asp.)

While the vast majority of life insurance policies are considered to be "registered products", Private Placement Life Insurance ("PPLI") policies may be customized and established without the regulatory oversight and restraints that apply to "registered" policies. PPLI is further discussed below in Section 11.





Private Placement Life Insurance Policies

Private placement life insurance (PPLI) allows for a wider range of investment options, but the IRS requires that the policyholder not have direct control over investments and that the investments be diversified. It is possible to have business entities and individualized investments, including investment real estate and even artwork and collectibles, held under a private placement life insurance policy. However, many very strict rules apply and must be adhered to in order to maintain the tax advantages of income and appreciation in value within the policy never being subject to income tax.

For example, a wealthy client might use a PPLI to invest in hedge funds and private equity. An independent investment advisor, rather than the client, manages the policy's investment choices. This structure complies with the investor control rules and ensures sufficient diversification.

It may be possible to sell an appreciated asset to a PPLI in exchange for a promissory note owed by the PPLI to defer income tax under the installment sale rules. The PPLI may then sell the asset shortly after purchasing it, and would not pay income tax on the gain. At a later time the promissory note may be paid in full, and the income tax on the sale of the asset to the PPLI may be recognized at that time. The income tax on the sale will not be avoided, but it will be deferred, perhaps to a year when the taxpayer, or the successors to the taxpayer, are in a lower tax bracket or better able to pay the tax.





Private Placement Life Insurance Policies

Frozen Mortality Accounts

Part of the reason that permanent life insurance is as expensive as it is, is that the death benefit must be maintained until the death of the insured. It may be possible to have a portion of the assets held under a PPLI policy set aside and earmarked to be used solely as the death benefit under what is called a frozen mortality account, which can replace the need to have reinsurance and a separate death benefit paid into the policy upon the death of the insured. This can dramatically lower the cost of maintaining a life insurance policy until the death of the insured person or persons, and may also eliminate the risk of a policy expiring before the death of the insured.

This is commonly referred to as a Hampton Freeze.

As an example, the Roberts family uses a frozen mortality account within their PPLI policy. By allocating \$1 million to this account, they reduce annual mortality charges from \$30,000 to \$8,000 and ensure the policy will not lapse at age 100.





Creditor Protection and State Law

Creditor protection is a key consideration, and now more important for a great many individuals and families who no longer have significant estate tax planning concerns. Anyone who drives in the United States or has errands run for them by an employee has a potential creditor protection problem. It is important to remind and educate clients with respect to the need for appropriate limits of liability, umbrella coverage, and recognizing other liability risks such as recreational property ownership, hunting, and professional or business liability. These often make creditor protection the most important thing on the asset protection list.

According to one source, the states that provide for full creditor protection for permanent life insurance policies on the lives of those who reside there, with unlimited cash value and death benefit creditor protection, are as follows:





Creditor Protection and State Law

<u>Parents' Ownership of Life Insurance Policies on the Lives of their Children May Not Have</u>

Creditor Protection

Many individuals have purchased life insurance on the lives of their children, both as an investment vehicle and as a means to help assure that their children will have life insurance in the future, regardless of changes to their children's health. Many parents believe that if they own a life insurance policy on the life of their child, it will be creditor-proof. This is not the case, as most states do not offer such protection when the owner of a policy is not the person whose life is insured.

It is a common misconception that simply owning a life insurance policy on another's life, such as a child, automatically confers creditor protection. In most states, the statutory protections for life insurance policies only apply when the insured is also the owner. If a parent owns a policy insuring their children and the parent is sued or files for bankruptcy, the policy's cash value may be available to the parent's creditors.





Creditor Protection and State Law

<u>Irrevocable Life Insurance Trust Ownership of Policies on the Lives of Children May Have</u> Creditor Protection

A policy on the life of a child may be owned by the spouse who is the least likely to lose the value to a creditor. Alternatively, the policy can be owned by an Irrevocable Life Insurance Trust for the child and the child's descendants, which may distribute the ownership of the policy to the child as a benefit when the time is right.

Using an Irrevocable Life Insurance Trust (ILIT) to own the policy can provide both creditor protection and estate tax benefits, as the policy is removed from the parent's estate and is not subject to the parent's creditors.

For example, the Johnsons (a father, mother, and son) are concerned about potential lawsuits against the father, who is a physician. The first option is to have the mother, who is not exposed to professional liability, own the policy on their son. Alternatively, they can establish an ILIT to own the policy, to assure that neither parent's creditors can reach the policy's value.





Portability Allowance and Estate Tax Exemption

When the estate tax exemption was \$600,000 from the years 1987 through 1997, and there was no **Portability Allowance**, it was often best to fund an **Irrevocable Life Insurance Trust**. This ensured that the life insurance death benefit plus up to \$600,000 of other assets could be held for the health, education, and maintenance and support of the surviving spouse in a credit shelter trust that was never subject to estate tax on the second death.

When the portability laws were passed in 2012, it became more important to place life insurance under an Irrevocable Life Insurance Trust in order to not reduce the Portability Allowance of the surviving spouse. For example, if the first dying spouse had \$2 million of investment and personal assets and a \$2 million life insurance policy and the estate tax exemption was \$5 million per spouse (which was the case in the year 2012), then the surviving spouse would receive a \$3 million Portability Allowance. This would occur if the life insurance was in an Irrevocable Life Insurance Trust and the remaining assets of the first dying spouse were \$2 million dollars, or a \$1 million dollar Portability Allowance if the \$3 million of assets and the life insurance were all in the estate of the first dying spouse.

This continues to be a consideration for individuals who may have large estates. For example, an individual with \$8 million worth of assets and a \$5 million life insurance policy could have the life insurance policy payable to a credit shelter trust with the rest of his or her assets in 2026, and assuming no prior use of the estate tax exemption, the credit shelter trust could be used for the health, education, maintenance, and support of the surviving spouse and pass estate tax-free on the surviving spouse's death.





Portability Allowance and Estate Tax Exemption, Cont'd

If the life insurance is held outside of an Irrevocable Life Insurance Trust, the surviving spouse will receive a \$2 million Portability Allowance. Alternatively, if the life insurance policy is held under an Irrevocable Life Insurance Trust that is properly structured and assuming that the policy was not transferred by gift to the trust within three years of the death of the insured, then the Life Insurance Trust and the credit shelter trust together provide the same estate tax, creditor claim, and divorce protection, but the surviving spouse will receive a \$7 million Portability Allowance.

Even clients who live in states that provide full protection of life insurance cash values from creditors can be well advised to implement or maintain an **Irrevocable Life Insurance Trust**.

Be careful if a client is under the federal exemptions, but would be subject to state estate or inheritance taxes if they move back to where they came from, particularly if they have children there that might be inclined to ask them to move back towards the end of their lives to have better care and for the convenience of the children.

Planners should consider that many of the northern states do not recognize portability, so it is important to fully fund a Credit Shelter Trust on the first death, in order to reduce what the surviving spouse's estate will be if he or she moves back to a state that imposes estate taxes. If the first dying spouse leaves a Q-TIP Marital Deduction Trust, the family may consider making a special election in the northern state to have the Q-TIP Trust or a part thereof be considered to be a Credit Shelter Trust in that state, even though neither spouse has recently resided there.





Valuation and Sale of Life Insurance Policies

Valuation of Life Insurance Policies is complex and depends on the insured's health, policy features, and market demand. Policies on individuals with short life expectancies may be worth far more than cash value. Note, the value of a life insurance policy for estate and gift tax purposes and fiduciary purposes is not necessarily the cash value or the surrender value thereof.

The value of a life insurance policy for estate and gift tax purposes and fiduciary purposes will normally be what a willing buyer would pay a willing seller for the policy. (See Valuation of Life Insurance Policies, John Hancock Insurance, https://theasagroup.com/wp-content/uploads/JHancock-Valuation-of-Life-Insurance-Policies.pdf (last visited July 14, 2025)).

The cash value or cash surrender value is what could be received if the policy is liquidated.

The Interpolated Terminal Reserve (ITR) value is the value that life insurance companies determine and use for calculating their regulatory reserve requirements and for producing their financial statements. Lastly, the PERC value is a market-based valuation methodology commonly used to calculate the fair market value of a life insurance policy by estimating the present value of future benefits, minus the present value of future costs, based on realistic policy assumptions — not just statutory accounting reserves like ITR — hence the name **P**remiums, **E**xpectation, **R**ealization, **C**ost or PERC method. Alternatively, if the insureds are in very poor health and have a short life expectancy, then the policy may be worth much more than the interpolated terminal reserve value.

Each such method arrives at a value that is based upon the health of the insureds when the policy was issued and what their health would be assumed to be, for example using the median health expectation. If the insured or insureds are in excellent health and expected to live well beyond their initially expected life expectancy, then the policy may be worth much less than the ITR value. (Should we capitalize the letters I, R, and T? Authorities are split on whether or not to capitalize here. Some sources on this topic, including Anderson *supra*, capitalize Interpolated Terminal Reserve. ("... typically provides the Interpolated Terminal Reserve (ITR)." Others, like John Hancock *supra*, do not capitalize it ("... a valuation method using an 'interpolated terminal reserve' value."). See also Interpolated Terminal Reserve Law and Legal Definition, USLegal, https://definitions.uslegal.com/i/interpolated-terminal-reserve/, (accessed July 15, 2025) ("Interpolated terminal reserve refers to..."). It appears the generally sources do not capitalize it when used in a sentence, but others do capitalize for stylistic purposes.)





Valuation and Sale of Life Insurance Policies

Alternatively, if the insureds are in very poor health and have a short life expectancy, then the policy may be worth much more than the interpolated terminal reserve value.

A 78-year-old, for example, who is terminally ill and holds a \$2 million life insurance policy with a \$300,000 cash value, might receive a \$1.2 million offer from a life settlement company, reflecting the policy's high value due to the short life expectancy.

However, caution is again prudent when considering the sale of a life insurance policy on the secondary market because regulations for life settlement sales are even more lax than for life insurance placements and replacements or exchanges. For instance, the life settlement secondary market includes both legitimate auctioneers and brokers, and, unfortunately, also buyers that aggressively market themselves with claims like "your clients are losing money if you don't work with us" and "but our process is proprietary so we can't tell you how or why we can get you higher purchase offers". As such, working with a broker that demonstrates a transparent process like the below increases the likelihood that clients actually received top-dollar when selling a life insurance policy.

Appraisal of fair market value in advance of any bids for context to determine good versus bad bids from the auction,

Life Expectancy (LE) reports from multiple LE providers again for determining good versus bad bids from the auction,

All Inclusive Auction for soliciting bids (or declines) form all buyers approved by the respective State Department of Financial Services/Insurance,

Bid History to confirm participation by all buyers and sufficient bidding activity to ensure the highest possible offer, and

Fee Disclosure to ensure fees and commissions paid to auctioneers and/or brokers are reasonable





LLC Structures and Discounting

Another possibility is to contribute the policy to a limited liability company (LLC) and to have the ILIT own a 1% voting member interest in the LLC and the 99% non-voting member interest. Then the 99% non-voting member interest could be valued with reference to discounts for lack of marketability and lack of control. This way, the 99% non-voting member interest might be purchased at least 30 days or more after the policy is placed into the LLC to avoid the step transaction doctrine at a significant discount, which may be in the area of 25 to 35%. A note may be given in exchange for the policy and might be secured by a lien against the policy. This structure allows for discounted transfers of policy interests, reducing gift or estate tax exposure. The IRS generally respects discounts if parties observe the formalities and timing.

As an example, the Blackwell ILIT contributes a \$1 million policy to an LLC. Thirty-five days later, the trust sells the 99% non-voting interest to a family member for \$700,000, reflecting a discount of approximately 30%.





Promissory Notes and Trust Administration

The promissory note should bear interest at a reasonable rate that a fiduciary would charge an arm's length borrower, which might be 2% above the prime rate, which is 7.5% as of the date of publication of this article. Approval of this type of transaction should normally be received by all adult beneficiaries of the trust and preferably by someone who is able to represent minor beneficiaries and unborn heirs. Alternatively, a certain dollar amount might be set aside to pass to the minors and unborn future heirs in exchange for not objecting to the sale at a discount based upon a court order and having had an independent ad litem appointed by the court to determine what an appropriate amount to set aside would be. Proper documentation, fair interest rates, and clear beneficiary consent can play critical roles in withstanding IRS scrutiny and avoiding fiduciary disputes.





Private and Contractual Annuities and Self-Cancelling Installment Notes

One aspect of estate tax planning is that someone who gives away a tree but retains the ability to eat the fruit of the tree will be considered to own the tree upon death. By the same token, someone who loans money and receives interest income will be subject to federal estate tax on the amounts that are still owed to that person upon his or her death, unless the note is a self-canceling installment note.

A self-canceling installment note works by having the lender charge a significantly higher interest rate than would otherwise apply to take into account that the note will cancel upon death. Most advisors use commercially available software that computes rates using the IRS actuarial tables that apply to private annuities and market interest rates, along with life expectancies to determine what the interest rate will need to be in order for the establishment of the note to be considered an arm's length agreement.

A similarly effective arrangement is for the taxpayer to buy a private or contractual lifetime annuity right. While both a self-cancelling installment note and a private annuity may appear to be similar to keeping the fruit from the tree, the estate tax laws are clear that when the payments cease upon death, there is no federal estate tax inclusion if these are properly structured.

For more information on structuring self-cancelling installment notes and private annuities sales, see Jerome M. Hesch and Elliott Manning, *Family Deferred Payment Sales Installment Sales, SCINs, Private Annuity Sales, OID and Other Enigmas*, 29 U. M. Sch. L. 1 (2009).

When a private annuity arrangement is entered into between the grantor of a trust and the trust itself, the Treasury Regulations impose what is known as the "probability of exhaustion test." This test requires that the trust have a net worth sufficient to make the private annuity payments based upon the assumption that the grantor will live until age 110 and that the trust assets will grow only at the Internal Revenue Code Section 7520 rate that exists at the time that the annuity is put into place. This rate is generally 120% of the midterm applicable Federal Rate, which is generally equivalent to the market value of a three to nine-year Treasury Bill. The probability of exhaustion test is designed to prevent taxpayers from using underfunded trusts to avoid estate tax. The trust must be able to make payments even under conservative assumptions.





Private and Contractual Annuities and Self-Cancelling Installment Notes

Buy Life Insurance to Avoid the Risk of Premature Death

One possible arrangement is to establish an Irrevocable Life Insurance Trust that would purchase a life insurance policy to offset the risk of the annuity or self-canceling installment note holder dying prematurely.

For example, Mr. Jackson, age 65, received a \$400,000 annual private annuity from his trust. To hedge the risk of dying early, the trust purchased a \$2 million 20-year term policy via an ILIT. If he died at age 75, his family will have received a total of \$4 million in combined annuity and death benefit payments.

The private annuity or self-canceling installment note can solve the estate tax problem for many families, assuming that the payments received are spent, gifted, or donated in sufficient amounts to keep the recipient below the estate tax threshold. This may require making multiple gifts of \$19,000 per year to or for the benefit of many family members, whether directly or using Crummey Trusts. It could also entail discounted gifting of non-voting or minority interest LLC interests, and/or donating funds or assets to public charities, or a private or family foundation, in an amount sufficient to remain under the threshold.

A parent, for example, receiving \$500,000 per year from a private annuity could gift \$19,000 each to 10 grandchildren and \$50,000 to a family charity foundation annually, reducing their taxable estate while avoiding estate tax on the annuity proceeds.

As stated above, payments received under a private annuity arrangement will normally be subject to income tax on the "interest income component," but this can be avoided if the payments are received from a grantor trust where the recipient of the payments is considered to be the owner of the trust for Federal income tax purposes.





Partnership Basis Bump Transactions – Now Reportable





Certain Basis Bump Transactions with Life Insurance-Funded Mixing Bowl Partnerships Are Now Reportable Transactions

The mixing bowl partnership involves setting up a partnership with one partner contributing appreciated assets and another partner contributing a life insurance policy or the partnership purchasing a life insurance policy using a cash contribution. The partnership liquidates after seven years and the assets are distributed to the partners so that a partner's basis in the appreciated assets are increased and the other partner's basis in the life insurance policy is decreased. The appreciated assets are then sold with little to no gain due to the increased basis. The life insurance policy is held until the insured's death at which point an income tax-free death benefit is paid, which provides a de-facto step-up in basis.

Professionals should review the recently released treasury regulations on partnership basis shifting that are transactions of interest because if the basis adjustment is over \$10M the mixing bowl partnership would appear to fall under the regulations, triggering reporting obligations for the client and material advisors. Additionally, as the strategy includes the transfer of life insurance policies, the transfer for value rules must be reviewed to avoid creating a taxable death benefit. (Michael Geeraerts & Jim Magner, Will the EOLI Tax Trap Capture Life Insurance Owned by a Family LLC, LISI Bus. Entities Email Newsletter No. 254 (2023). For further discussion on the employer-owned life insurance rules applying to family partnerships.)





Is the Liquidating Distribution of the Policy a Transfer for Value?

If the partnership's liquidating distribution of the policy to the non-grantor trust is a transfer for valuable consideration, the death benefit above the trust's basis in the policy is taxable ordinary income. As the policy is being distributed as a liquidating distribution from the partnership in exchange for the trust's partnership interest, that is a transfer for valuable consideration. If there is no exception to the transfer for value, the death benefit will not be entirely income tax-free. If the trust is not a grantor trust with respect to the insured, the exception for a transfer to the insured is not available.

Typically, when a partnership distributes a policy to a partner in a non-liquidating distribution, the partner takes a carryover basis in the policy equal to the partnership's basis as long as the partner has sufficient outside basis in the partnership interest, and carryover basis is an exception to the transfer for value rule. However, in this case, the trust, as the partner receiving a liquidating distribution, is not taking a carryover basis because the trust's basis is not what the partnership's basis was before the distribution.

With respect to the transfer to a partner of the insured exception, the insured and the non-grantor trust were partners. However, after the liquidation of the partnership, they are no longer partners unless there is another partnership between the insured and the trust. When the partnership liquidates and distributes all its assets in exchange for partnership interests, the partners may cease to be classified as partners after the liquidation, so it is important to review whether the insured and trust can rely on the transfer to a partner of the insured exception.

If the trust is a grantor trust with respect to the insured, the trust may need to own another entity, such as an S corporation, with the insured as a partner. Suppose the partnership makes a liquidating distribution to the S corporation. In that case, that is a transfer for value and, unless the insured is an officer or shareholder of the S corporation, there is no exception to the transfer for value rule. The carryover basis exception would not apply to a liquidating distribution where the partnership's basis in the policy is not transferred to the partner. If the S corporation distributes the policy to the grantor trust, this subsequent transfer may qualify for the transfer to the insured exception. However, if the partnership's distribution to the S corporation is a reportable policy sale, the death benefit received by the trust may still not be entirely income tax-free. Financial professionals must review the ownership of the entities to ensure there is no reportable policy sale.

Is the Liquidating Distribution of the Policy a Transfer for Value?

Some mixing bowl partnership liquidations may end up with the insured receiving a liquidating distribution of the life insurance policy, with other assets going to a trust. For example, an individual may contribute low-basis, highly appreciated assets to a partnership, and his irrevocable trust contributes a high-basis life insurance policy. After seven years, the partnership liquidates and distributes the insurance policy to the insured and other assets to the trust, with the trust taking an increased basis in the assets. If the policy is transferred to the insured, that will be an exception to the transfer for value rule.

The trust's assets are out of the insured-grantor's estate, and the trust can sell the assets with little or no gain because of the trust's increased basis. If the insured owns the life insurance policy, the death benefit will be included in the insured's estate. However, the insured could remove the policy by gifting it to an irrevocable trust or family member (subject to the three-year lookback under IRC \$2035), or sell the policy to a grantor irrevocable trust for fair market value to avoid the three-year lookback, assuming no step transaction argument. The estate and income tax consequences of the partnership's liquidating distributions of assets and life insurance policies must be kept in mind, given the federal estate tax rate of 40%. In comparison, the federal long-term capital gain rate may be 15%, 18.3%, or 23.8%. Having a large death benefit included in the insured's estate may result in more taxes compared to selling the original asset at a gain, since estate taxes may outweigh the income tax savings.





Marketable Securities

Clients may contribute highly appreciated publicly traded stock to a partnership. Usually, no gain is recognized on the contribution under IRC §721. However, when marketable securities are involved, the investment company rules must be checked. For example, suppose a trust contributes \$10 million of marketable securities with a \$1 million basis in exchange for a 50% partnership interest, and another partner contributes \$10 million cash for the other 50%. In that case, there is typically no gain recognized on the contribution. However, the term "money" includes marketable securities, so gain may be recognized on distributions if the money distributed exceeds a partner's outside basis.

IRC §721 generally provides non-recognition of gain when appreciated assets are contributed to a partnership for a partnership interest. However, there is an exception under IRC §721(b) if the partnership would be treated as an investment company under IRC §351 if it were incorporated. If over 80% of the partnership's assets (excluding cash and non-convertible debt) are marketable securities, interests in regulated investment companies, or REITs, and the contribution diversifies the contributor's portfolio, gain recognition may apply.

Diversification means no more than 25% of assets are invested in one issuer's securities and no more than 50% in five or fewer issuers, according to Treas. Reg. §1.351-1(c)(6)(i). The investment company rule is designed to prevent using partnerships to diversify without recognizing gain, and must be reviewed when marketable securities are contributed to a "mixing bowl" partnership.





704(c) Depreciation

If depreciable property is contributed to the partnership, IRC § 704(c) impacts the allocation of the depreciation deductions, which impacts the partners' outside basis. In a 50/50 partnership, depreciation would usually be shared 50/50, but IRC § 704(c) generally requires tax depreciation to be allocated to the non-contributing partner until he is allocated tax depreciation equal to the book depreciation allocation. A partner's outside basis would be impacted for the allocation of depreciation deductions and a lower outside basis would result in a partner taking a lower basis in the assets distributed to him in a liquidating distribution.





Economic Substance Doctrine

Importantly, IRC § 7701(o) codified the economic substance doctrine states that a transaction will have economic substance only if 'the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction.' The codified economic substance doctrine applies to individuals only when transactions are entered into in connection with a trade or business or an activity engaged in for the production of income. If the mixing bowl partnership is deemed to be entered into in connection with a trade or business or for the production of income, the economic substance doctrine could come into play and the client may have to explain how the transaction meaningfully changed (other than the tax benefit) his economic position and that there was a substantial purpose (other than tax savings) for entering into the mixing bowl partnership.

In Rev. Rul. 2024-14, the IRS ruled the economic substance doctrine was not met for a series of transactions involving a related-party partnership that were undertaken by a controlled group because the series of transactions did not change the taxpayer's economic position in a meaningful way and a substantial business purpose was not established. Therefore, the IRC § 754 basis increase that causes increased depreciation deductions and/or reduced gain on sale were disregarded.





Basis Shifting Transactions of InterestRegulations

The Service recently released final regulations on Certain Partnership Related-Party Basis Adjustment Transactions as Transactions of Interest. [11] Professionals advising clients of a mixing bowl partnership transaction should keep the reporting obligations under the regulations in mind. The reporting obligations apply to material advisors as well. The regulations are effective January 14, 2025. Treas. Reg. § 1.6011-18(c) states:

A transaction is described in this paragraph (c) if the factual elements of the transaction described in paragraph (c)(1)(i) through (iii) or (c)(2) of this section are met.

- (1) Distributions by a partnership. A partnership with two or more related partners engages in any of the transactions described in paragraphs (c)(1)(i) through (iii) of this section as follows:
- (i) The partnership distributes property to one of the related partners in a current or liquidating distribution, the partnership increases the basis of one or more of its remaining properties under section 734(b) and (c) of the Code, and the applicable threshold described in paragraph (c)(3) of this section is met.
- (ii) The partnership distributes property to one of the related partners in liquidation of that person's partnership interest (or in complete liquidation of the partnership), the basis of one or more of those distributed properties is increased under section 732(b) and (c) of the Code, and the applicable threshold described in paragraph (c)(3) of this section is met.
- (iii) The partnership distributes property to one of the related partners, the basis of one or more of those distributed properties is increased under section 732(d) of the Code, the distributee acquired all or a part of its interest in the partnership in a transaction that would have been a transaction described in paragraph (c)(2) of this section if the partnership had a section 754 election in effect for the year of transfer, and the applicable threshold described in paragraph (c)(3) of this section is met.

Navigate With Confidence

Basis Shifting Transactions of Interest Regulations

The applicable threshold is \$10M, although it is increased to \$25M for purposes of a six-year lookback period for these transactions of interest done in prior tax years. The Service's interest in these transactions is that the basis increase to the distributed property allows the related parties to significantly decrease taxable income through increased cost recovery allowances or decrease taxable gain on the disposition of the property subject to the basis increase.

Treas. Reg. § 1.6011-18(c)(1)(ii) implicates a mixing bowl partnership distribution because the partnership distributes property to a related partner in liquidation of that partner's partnership interest and the basis of the distributed property is increased under IRC § 732(b). If the applicable threshold is met, the distribution is a transaction of interest subject to its reporting obligations. Determining if partners are related for purposes of the transaction of interest regulations generally looks to the relationships under IRC § 267(b), which would include brothers and sisters, spouses, ancestors, lineal descendants, and a grantor and his trust.

While the mixing bowl partnership may be pitched, clients may be hesitant to engage given the seven-year waiting period. Plus, if the basis adjustment is \$10M or more, the final treasury regulations make it a transaction of interest, and clients may want to avoid all of the various reporting requirements. Further, transfer for value issues must be reviewed closely, otherwise the benefits of the transaction may be lost if the death benefit is partly taxable.

Clients may be more interested in the more time-tested strategies to help minimize and/or spread-out gain recognition, such as installment sales and charitable remainder trusts. For clients who have low basis assets that are already in existing irrevocable grantor trusts, trusts that provide an IRC § 675 substitution power may provide a client with another avenue to get the low basis assets out of the trust back into the client's estate so the assets can obtain a step-up in basis at death. While the mixing bowl partnership may have some appeal, there are some issues clients and their financial professionals may need to work through.





EXCERPTS FROM

LIFE INSURANCE: THE GOOD, THE BAD AND THE UGLY

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Saturday, September 9, 2023

From 11:00 AM TO 12:00 PM EST

(60 minutes)



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Split-dollar life insurance is defined under Treas. Reg. § 1.61-22(b) as an arrangement between an owner of a life insurance policy and a non-owner governed by the following terms:

Either party pays, directly or indirectly, all or a portion of the premiums of a life insurance policy;

At least one party has the right to recover all or any portion of premiums paid out of the proceeds of the life insurance policy; and

The policy is **not** part of a group-term life insurance plan compliant under § 79, unless such plan provides permanent benefits (i.e. cash value)

Treas. Reg. § 1.61-22(d)-(g) prescribes unique tax consequences for both the owner and non-owner in a non-loan split-dollar life insurance arrangement.





A split-dollar arrangement is either a "non-loan split-dollar" arrangement or a "loan split-dollar" arrangement. If the premium payor is not also the owner, the arrangement is classified as a loan arrangement because the payments are considered non-interest-bearing loans. Different tax consequences apply for each arrangement. In most family planning scenarios, non-loan split-dollar arrangements will be used. We will assume a non-loan scenario for purposes of this presentation.

Under Treas. Reg. § 1.61-22(d), the **non-owner** in a non-loan split-dollar arrangement receives an "**economic benefit**" and must include the value of the economic benefit in gross income. The economic benefit is measured as:

The cost of current life insurance coverage; plus

This is typically measured using the Table 2001 rates and multiplying them by the amount of coverage (total death benefit **minus** reimbursement to the owner under the split-dollar agreement)

The amount of cash value (disregarding surrender charges) to which the non-owner has **current** access; plus

The value of any other economic benefits to the non-owner.





The most common use of split-dollar arrangements is between employers and employees. Life insurance is used as a perk to entice the employee to continue providing services to the employer. Unlike life insurance used in a deferred compensation plan under § 409A, the employer does get a deduction for the economic benefit conferred to the employee, which the employee includes in gross income as compensation for services rendered.

Split-dollar life insurance can be used in several combinations. The non-owner can be the employee or a trust for the benefit of the employee's family members. The owner can be an employer or a welfare benefit plan. The various combinations of split-dollar arrangements will carry different tax and non-tax advantages and drawbacks.



In addition to the unique tax consequences for split-dollar life insurance arrangements under Treas. Reg. § 1.61-22, these arrangements have interesting non-tax consequences.

One such non-tax consequence is that while the split-dollar agreement is in place, the insurance and its cash value is likely **inaccessible to the non-owner's creditors** if the arrangement is structured correctly. Therefore, if a policy insures a key employee and the key employee is considered the owner of the policy under the split-dollar agreement, then the non-owner employer's creditors should not be able to access any part of the policy.

This can lead to interesting asset protection uses for businesses with significant cash reserves.



In addition, Treas. Reg. § 1.61-22 specifically contemplates split-dollar arrangements between family members, known as "private split-dollar." *See, e.g.,* Treas. Reg. §§ 1.61-22(b)(iii)(2)(iii)(C)(3)(ii)(B), 1.61-22(c)(2). Originally, the most common private split-dollar situation involved one or more children paying the premiums on a policy insuring the parent. The children would be treated as owner, and the parent would be treated as non-owner. The split-dollar agreement would provide that at parent's death, the children would receive the greater of (1) premiums paid or (2) cash value.

The advantage of this split-dollar arrangement was that it could provide funding for a policy on a parent's life that might be used to pay transfer taxes or otherwise create wealth, but the child would not be deemed to have made a taxable gift except to the extent of the economic benefit conferred.

No big deal, right? Well, if the parent lived a very long time, the economic benefit grew astronomically in value each year. With that growth came an imputed gift from child to parent. The imputed gift quickly became very costly, and the split-dollar arrangement would likely have to end, or the policy would have to be surrendered. Even if the parent died before the gift become intolerably expensive, the death benefit would be included in the parent's estate to the extent it exceeded parent's available exemption.





Because of the substantial gift tax risk, the traditional child-to-parent split-dollar arrangement struck many clients as unpalatable. However, what if the roles were reversed: parent now buys insurance on child's life using a private split-dollar arrangement. Parent is considered the owner, and Child's ILIT is considered the non-owner.

Because Parent has ownership of the cash value, the structure is treated as a non-loan arrangement in which the Parent is owner and the ILIT is non-owner. Every year, the economic benefit is considered an imputed gift from Parent to ILIT. However, this gift is more palatable because it is usually covered by the annual gift tax exemption and does not increase as markedly year-over-year as it would for Parent.



Assume Parent dies. Parent does not possess the full value of the actual policy, but instead possesses a right to reimbursement under the split-dollar agreement (effectively a receivable). The major question: **How do you value this right/receivable?** The answer is subject to considerable debate.

In a variation of the transaction, Parent sells the receivable to an entity other than Child's ILIT for the receivable's fair market value, as determined by a qualified appraiser. This variation comes with a certain degree of additional risk.



Is private non-equity collateral assignment split dollar even eligible for a discount?

Is § 2703 applicable to deny a discount?

Is Treas. Reg. § 1.61-22(b)(iii)(2)(iii)(C)(3)(ii)(B) applicable to the arrangement, thus qualifying the arrangement for economic benefit treatment rather than loan treatment?

If Parent sells, gifts, or bequeaths the split-dollar receivable to Child's ILIT or to another party...

Is the transfer a modification under Treas. Reg. § 1.61-22(c)(2)(B)(2), which would render the entire policy a gift to Child's ILIT?

Would common law principles (i.e. substance over form) re-characterize the transaction?

Bottom line: adding a sale/gift of the receivable (or bequeathing the receivable to the ILIT or its beneficiary) would probably boost the risk level by a significant margin. Proceed with caution!





In a variable life insurance policy, assets are kept in a separate account, from which mortality costs and certain expenses are deducted yearly. The income generated by assets in the separate account is exempt from current taxation under § 72 and is not taxed until the policy is surrendered or the policy lapses. This incentivized taxpayers to use life insurance policies as investment vehicles. Congress curbed some of this activity by passing §§ 7702 and 7702A, which laid forth certain scenarios in which a life insurance policy would not be taxed as a life insurance policy.

Under § 7702, a "cash value buildup test" applies to determine whether the policy should be taxed as a life insurance policy. If the policy fails this test, all income from both the inside build-up and the death benefit will be rendered currently taxable.

Under § 7702A, a "seven-pay test" applies to determine whether the policy is a "modified endowment contract" (or "MEC"). If the policy is a MEC, only the tax-deferred nature of the inside build-up is lost. The death benefit is still tax-free.





However, so long as a policy passed the tests under §§ 7702 and 7702A, the inside build-up and death benefit would both remain free of current income taxation. This meant policies with an investment component would still be viable.

In a retail variable life insurance policy, the only investments available in the separate account are those investments pre-selected by the issuing insurance company. Therefore, the policy owner is restricted by a "menu" of available investments. For some clients, this makes variable life insurance considerably less attractive.

Life insurance professionals eventually asked: "Why can't we create a product that would allow access to a broader selection of investments for the separate account of a variable life insurance policy?"



The answer to the question came in the form of **Private Placement Variable Life Insurance (PPVLI).** Rather than purchasing a policy from a traditional issuer, the client can purchase a custom-designed policy unrestricted by a "pre-selected" investment menu. Besides meeting the tests in §§ 7702 and 7702A, the policy must also meet the following requirements:

Diversification in accordance with the RIC rules under § 851(b)(3) to meet the safe harbor in § 817(h)(2); and

No investor control, a doctrine developed by the IRS in Rev. Rul. 77-85, 1977-1 C.B. 12 and refined over several other Revenue Rulings. The Tax Court afforded the investor control doctrine *Skidmore* deference in *Webber v. Commissioner*, 144 T.C. No. 17 (2015).





Investor control is typically avoided through the following measures:

Formation of a custom insurance-dedicated fund (IDF). Under Rev. Rul. 82-54, 1982-1 C.B. 11, and Rev. Rul. 2003-91, 2003-2 C.B. 347, an IDF will not trigger investor control, provided the IDF itself is diversified. An IDF must only allow for the cash value of annuities and life insurance policies to invest; participation cannot be open to the general public. *See* Rev. Rul. 81-225, 1981-2 C.B. 12.

The IDF manager, who selects the individual investments, must meet the following criteria:

- 1. Must be a third party unrelated to the policyholder.
- 2. Must not accept anything more than broad general input from policyholder regarding how to invest and manage the assets.
- 3. Must perform its own due diligence regarding each individual investment.

Avoidance of all indicia of ownership. The policyholder cannot manage, directly access, or exercise any powers conferred by the policy's assets. Access can only be achieved through policy loans.





PPVLI has the following uses:

For high-net-worth individuals who enjoy owning alternative assets giving rise to ordinary income, PPVLI avoids the current income taxation on these tax-inefficient assets. Such assets might include long-short equity hedge funds, international bond funds, REITs, MLPs, and investments requiring mark-to-market treatment under § 1256.

For non-resident aliens who wish to invest in U.S. assets, PPVLI avoids non-resident alien withholding, ECI issues, FIRPTA, ineligibility for a § 1031 exchange, and other adverse consequences of non-resident alien ownership. This is because the PPVLI can simply make a § 953(d) election to be treated as a United States taxpayer, even if the policy is actually located offshore.



The financial beauty of cash value life insurance is that it can provide a minimum rate of return guaranteed by a fiscally robust issuer. This creates opportunities to leverage or arbitrage a life insurance policy when combined with well-established charitable strategies.

"Split-interest trusts" come in four charitable varieties:

Either a **lead trust** or a **remainder trust**, defined by whether the charity receives distributions during the term of the trust or a single distribution at the time of termination; and

Either an **annuity trust** or a **unitrust**, defined by whether the lead interest is a fixed amount or a percentage of the trust corpus.

The varieties are abbreviated as a CRUT, CRAT, CLAT, and CLUT.



Different charitable deductions apply depending on the variety of trust being used. These deductions are calculated using government tables, which do not account for individual factors such as gender and health (only age).

For **remainder trusts**, certain testing applies to ensure that the charity will receive a remainder interest upon the termination of the trust. The concern is that the trust corpus will be exhausted by the time the trust term expires, leaving the charity with nothing.

For **lead trusts**, the charity's estimated payouts over the life of the trust determine the current deduction. The payout stream is discounted to present value using the § 7520 rate.



Because the government is using uniform actuarial tables and the § 7520 rate to discount to present value, the guarantees associated with life insurance's internal rate of return and death benefit (for permanent policies) can lead to excellent opportunities for leverage and arbitrage when combined with charitable split-interest trusts. The benefits are available either through contributing a policy to a charitable trust or by using a policy in conjunction with a charitable trust.

Example: Client has a highly appreciated work of art that will be taxed at a higher federal long-term capital gain rate when sold because it is a collectible. Client desires to liquidate the asset for much-needed money to live on, but Client fears the tax consequences of selling the work of art outright.





Solution: Contribute the work of art to a special type of CRUT known as a "flip" NIMCRUT (net income with makeup CRUT). This will allow the CRUT's trustee to sell the work of art before beginning the unitrust distributions. Client enjoys the charitable deduction prescribed under the Code and a stream of income for life under the unitrust.

The Catch: If Client dies early, Client experiences major adverse consequences. The CRUT's assets go to charity, any remaining loss carryovers extinguish upon Client's death, and Client's heirs are left without the benefit of Client's hard-earned assets.

The Hedge: Client combines the CRUT with either a term policy or a permanent policy, ensuring Client's heirs receive a tidy sum regardless of whether Client lives or dies.



Example 2: Client wants to take advantage of the transfer tax benefits of a lifetime CLAT, but Client is concerned that (1) contributing marketable securities is too risky to assure a return that outstrips the § 7520 rate, and (2) the charity is not guaranteed to receive its share of the money. If Client can achieve such a return on a reasonably guaranteed basis, Client can assure that a pool of money will be left over for the charity, and the arbitrage will open up transfer tax benefits for other assets.

Solution: Client can use a permanent life insurance policy to guarantee a sufficiently high level of return over the course of her lifetime. However, Client must be careful not to violate § 170(f) and other provisions governing life insurance owned within a charitable trust.





Wait a second. That sounds like charitable split-dollar, which you just said was a listed transaction. Isn't this charitable split-dollar? A CLAT owning a life insurance policy is not substantially similar to charitable split-dollar for the following reasons:

Under charitable split-dollar, the taxpayer effectively manufactured a tax deduction for life insurance premiums. In a CLAT, the life insurance policy is either directly or indirectly paid for with the taxpayer's after-tax assets.

Under charitable split-dollar, the charity paid some portion of the premium. In a CLAT, the charity never pays any part of the premium.

Under charitable split-dollar, the charity received only a small portion of the death benefit. In a CLAT, the charity is irrevocably designated as the beneficiary of the policy and will therefore receive the entire death benefit.

Thus, the tax consequences significantly differ between the two situations.





The Good: Pension "Sponge" or "Rescue"

Qualified plans remain one of the best legal tax shelters available, and their asset protection benefits are unmatched by any other vehicle.

To maximize tax deductions, ensure proper funding for defined benefit plans, and "supercharge" the potential wealth creation of qualified plans, many clients opt to fund these plans with permanent life insurance policies. Doing so is allowable under § 412(e)(3), the successor provision to § 412(i).

The Problem: When life insurance remains inside a qualified plan, the death benefit actually gets taxed twice when the plan participant has a taxable estate. The first layer is the estate tax, a combined 56% at the federal and state level. The second layer is the federal and state income tax, a combined 52% at the highest marginal rate in New York City. All told, the death benefit (and any other qualified plan assets) can be taxed at a combined rate of almost 79%! For every dollar in the qualified plan of a participant with a taxable estate, her heirs will only keep

TWENTY-ONE CENTS!





The Good: Pension "Sponge" or "Rescue"

Solution: Because the value of the life insurance will typically balloon at death, "rescuing" the policy is more important than "rescuing" the plan's other assets. The policy is "rescued" by forming an ILIT and funding it with low-basis, taxinefficient assets. These assets are then swapped for the life insurance policy within the qualified plan.

The policy's fair market value (and, therefore, its purchase price) is determined under Rev. Proc. 2005-25, 2005-1 C.B. 962, which prescribes an IRS-approved formula. The formula is different for variable and non-variable contracts.

Result: The life insurance policy is owned in a trust, where the death benefit can be collected free of both income and estate taxes. Low-basis, tax-inefficient assets are given more tax-efficient treatment in the qualified plan, where they will receive a step-up in basis and will not be subject to any current income taxation.





The Good: Pension "Sponge" or "Rescue"

But wait... aren't the swapped tax-inefficient assets still subject to the same 79% tax problem you described earlier? Yes, they certainly are.

So how do you propose we solve that issue? Clients can combine a charitable split-interest trust (described earlier) with a Roth conversion to achieve more taxefficient treatment for the qualified plan assets. The client offsets the ordinary income from the Roth conversion with the charitable deduction from the split-interest trust. If necessary, life insurance is added to hedge against the potential for adverse consequences.

Now, at death, the heirs avoid an entire layer of taxation while gaining one of the most powerful tax and asset protection vehicles ever invented: the Roth IRA, which is protected from creditors if bequeathed to a properly designed IRA Beneficiary Trust. Heirs invest tax-free through the Roth IRA and can choose maximum flexibility through a "Self-Directed IRA." RMDs are "stretched out" over the respective lives of each individual heir.





The Good: COLI/BOLI

Common problem faced by banks, property and casualty insurance issuers, large corporations, and their CFOs: they want to ensure their cash reserves are earning returns, but they also want to display the highest possible amount of assets on the entity's balance sheet.

For **banks**, this means a greater wherewithal to lend money.

For **property and casualty insurance issuers**, this means a greater wherewithal to write more insurance against the company's reserves.

For **large corporations**, this means a greater valuation, which is especially important when the company is publicly traded.

For companies invested in marketable securities, those marketable securities are treated differently when "wrapped" as part of a variable life insurance policy. Common concerns:

Who is typically the insured? A healthy key employee is typically the insured. The entity is the beneficiary.

What if I need to get my cash value out of the policy? No problem— the policy can be designed with 100% surrender value and 24-hour liquidity.





The Good: COLI/BOLI

Will the insurance company "collar" the investment returns? Maybe, depending on product design. If you don't want collars, you can obtain a policy without them, or you can always opt for whole life or guaranteed universal life.

Who else has already done this? A majority of companies in the Fortune 1000 have done this. A 2002 article in the *Wall Street Journal* highlighted this practice.

Didn't Congress crack down after that? Yes—since 2006, you can no longer unilaterally take out "dead peasants insurance" or "janitor insurance." Under § 101(j), you must notify rank-and-file employees whenever you insure their lives. Therefore, COLI/BOLI is mostly used on key employees.

I heard somewhere that corporations used this as an illegal tax shelter. They did at one time—it was called "leveraged COLI," and the strategy involved borrowing money to fund premiums in order to obtain the tax benefits. This transaction was listed by the IRS and is no longer used.





The Good: Curing Inefficiencies

The details that can make or a break a client's success include:

Underwriting – How to shop a client's profile to multiple insurers and effectively start a bidding war for the best policy– and how to avoid fatal mistakes that may disqualify the client from ever buying life insurance

Pricing – For instance, how to tell whether a client can accomplish her objectives through a survivorship policy or a much cheaper single life policy on only one spouse

Policy Features – Some companies' products are simply better than others and may lead to spectacular results in the right circumstances – some clients were entirely protected from downside in the Great Recession

Life insurance, as an asset class, can result in maximum *efficiency* in planning. *Efficiency* means optimal tax and non-tax planning outcomes with minimal headaches. Achieving this lofty goal requires intimate knowledge of the industry landscape and the many hidden advantages and disadvantages not widely known among most professionals. This savvy often makes the difference between the best professionals and everyone else.







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Thank You



