WRMarketplace
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The *WRMarketplace* is created exclusively for AALU members by experts at Greenberg Traurig and the AALU staff, ledby Jonathan M. Forster, Steven B. Lapidus, Martin Kalb, Richard A. Sirus, and Rebecca Manicone. *WRMarketplace* #17-38 was written by Greenberg Traurig Shareholder Jonathan M. Forster.

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TOPIC: Life Insurance – A Remedy for Uncertainty.

MARKET TREND: In this uncertain environment, a flexible and team-based advisory approach can help life insurance plans move forward.

SYNOPSIS: In an uncertain environment, clients should still move forward with life insurance planning because it: (1) focuses clients on analyzing the assets required to maintain their lifestyle, (2) implements needed planning without leaving clients feeling "locked-in," and (3) offers both a lifetime investment component and death benefit protection, while simultaneously addressing practical needs and tax considerations.

TAKE-AWAYS: Even with higher estate tax exemptions and the specter of repeal, life insurance remains important to tax and legacy planning based on its: (1) distinct characteristics (instant, mortality-based liquidity and cash accumulation and death benefit payments) and (2) multi-purpose application (tax, retirement, and liquidity planning, investment management and diversification, and family security). Motivating clients to move forward with life insurance purchases may require a reminder of these attributes and how they can complement the client's overall goals. Educating and coordinating with allied advisors to present a unified legacy and life insurance plan will help.

An uncertain tax environment makes it even more critical for clients to move forward with life insurance planning. Five key considerations are discussed below.

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LIFE INSURANCE PLANNING MOTIVATORS

1. Planning Capacity. Clients may instinctively worry about using their cash flow or liquid assets to fund life insurance premiums, even though they lack a complete understanding of their spending needs and net worth. An analysis of a client's lifestyle capital (the minimum assets needed to cover annual living expenses, promote family goals, and maintain a family's lifestyle long-term, after inflation and taxes) versus the client's legacy capital (the assets remaining in excess of lifestyle capital, which a client can comfortably transfer) can provide clients with a more accurate picture and offer concrete numbers identifying the client's legacy capital available to implement their life insurance plan without affecting their lifestyle. Monte Carlo or similar analyses can help in determining these amounts.

2. Flexibility. Clients often express concerns about implementing the "wrong" plan (and paying the associated costs) in an uncertain environment. Illustrating the flexibility available with life insurance planning may help motivate these clients. For example, policies acquired with return of premium riders can return premiums to clients if they decide to cancel the policy. Clients also can select or change the mode of premium payments (monthly, quarterly, annually), reduce a policy's face amount, stop paying premiums, etc. to adjust to future circumstances, or simply buy convertible term now. Purchasing a policy now ensures a client's insurability and can provide a better internal rate of return when the insured has a longer life expectancy and is in good health; however, since clients can "pull the plug" on the planning, they won't feel locked-in.

3. Expanded View of Life Insurance. Even investment-savvy clients may have preconceived notions regarding life insurance, seeing it simply as an added expense that offers only death benefit protection. These clients may be unaware that the current life insurance market provides a wide variety of life insurance products with cash value features that support both estate planning and lifetime retirement planning goals. Even with higher federal estate tax exemptions, individuals can use these policies as vehicles for providing cash accumulation and retirement savings during life, as well as earnings replacement and family security in the event of an untimely death.

Many high cash value life insurance products also can provide flexible methods to diversify an investment portfolio. For instance, current assumption universal life and whole life products, which typically benefit from a rising interest rate environment, may become more attractive. Reviewing analyses that show not only the internal rate of return ("**IRR**") relative to life expectancy ("**LE**") for a policy's death benefit, but also an IRR analysis of the policy cash value (during the insured's life) relative to LE can help demonstrate how life insurance can complement a client's broader investment planning goals and dispel any misconceptions.

4. Tax Considerations. For tax purposes, growth within a life insurance policy during the insured's life and payment of the policy death benefit upon the insured's passing generally are not subject to income or capital gains tax, based on longstanding and appropriate tax principles. Further, the policy owner may be able to access cash value through policy loans or withdrawals (up to the owner's basis in the policy) without current income tax (assuming the policy is not a modified endowment contract (**MEC**)).

Finally, if held in an irrevocable trust, the policy death benefits also should be excluded from the insured's taxable estate.

5. Multi-Purpose Application. Complementing the above, demonstrating the multi-purpose application of life insurance also may motivate clients less focused on estate tax issues. Practically, life insurance, especially if held in trust, can: (1) minimize family conflicts, (2) provide liquidity for family support and post-death expenses, (3) offer creditor protection, (4) allow equalization among active and non-active heirs with regard to the family business, and (5) provide long-term wealth and tax management (e.g., allow for the grantor's substitution of trust assets).

6. Allied Advisors. Just like clients, allied advisors (e.g., accountants and attorneys), may have fixed and limited notions of how life insurance can work in a client's plan, creating "roadblocks" to planning. Divided advisors cause confusion and frustration for clients, making it more likely that they will give up on the life insurance plan. Bringing in other advisors early on, explaining the options and how they can help the client's overall plan, and keeping the lines of communication open can help get all client advisors on the same page. Life insurance advisors that operate as a team and keep an open dialogue with other client advisors will have the most success in completing a client's life insurance transaction.

REAL WORLD APPLICATION

The importance and flexibility of life insurance planning can be shown in the case of an irrevocable life insurance trust (**ILIT**) offering spousal lifetime access (i.e., a "**SLAT**").

Meet the Clients. Ben and Ashley, ages 50 and 44, respectively, are married with two minor children. They have a net worth of $15 million, a good part of which is concentrated in a closely-held business founded by Ben. The company is successful and currently makes regular cash distributions. To provide liquidity to the family at Ben's passing with access to lifetime benefits, Ben and Ashley's life insurance advisor (**LIA**) wants to recommend the purchase of a non-MEC policy insuring Ben with a $6 million death benefit and a significant cash value component.

The LIA asks Ben and Ashley if he can include their business accountant and estate planning attorney to help determine the couple's available cash flow, ensure the death benefit provides sufficient liquidity, and use the most efficient approach to buy and hold the policy. Working with these advisors, the LIA is able to suggest a SLAT created by Ben. Ben would fund the SLAT with a gift of a portion of his business interests, allocating part of his federal gift tax and GST tax exemptions to the gift. The SLAT would be a grantor trust for income tax purposes with regard to Ben.

In addressing Ben and Ashley's concerns about moving forward with this plan in light of the uncertain tax environment, the LIA, with the contribution of the other advisors, can respond:

- ***Life insurance offers a cost-effective mortality hedge to protect a family's security*** (i.e., amount of premiums relative to death benefits).
- As a ***grantor trust***, Ben will be taxable on the SLAT's income, but the tax treatment of the SLAT's policy helps mitigate this issue.
- The SLAT ***can make distributions to Ashley***, including through access to policy cash value or loans if needed to support these distributions.
- The death benefit provides ***estate liquidity without additional tax liability,*** allowing Ben to retain his business interests in his estate for a basis step-up.
- Ben also can have a ***substitution power over the trust assets***, which would permit him to swap out the SLAT's business interests for assets of equivalent value, and an independent person can have authority to ***grant general powers of appointments*** to Ben's descendants to ***achieve a basis step-up for trust assets***.
- The distributions received by the SLAT from its business interests can help fund policy premiums. Added funding options include providing for "Crummey" withdrawal powers in the SLAT to allow for annual exclusion gifts and/or the use of a split-dollar agreement.
- Structuring the SLAT as a dynasty trust after Ashley's passing can provide ***long-term creditor protection and wealth stewardship*** for Ben and Ashley's descendants.

TAKE-AWAYS

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