3 Life Insurance Planning Ideas:
(1) Levine Split-Dollar
(2) Clawback
(3) SLATs

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A KEY ESTATE PLANNING GUIDE

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Life Insurance Planning Ideas and Defensive Practice May Go Hand in Hand

Introduction

Introduction

- This presentation will discuss three possible approaches that estate planning professionals, and in particular, insurance professionals, may consider in the current planning environment.
- For estate planners generally, but in particular for estate planning attorneys, suggestions as to how insurance planning may be **protective of the adviser are highlighted in purple**.
- For those interested, practical ideas to increase insurance sales, so much so that **key insurance sales ideas will be highlighted in blue**.
- Three key ideas will be presented:
- 1. The recent Levine case which gives, some think, a recipe to **sell life insurance using an economic benefit split-dollar regime**. Caution is really in order as although the Levine case was a taxpayer victory, there may be considerable risk with this type of planning approach, and there are definitely several potential tax planning drawbacks. Practitioners should consider advising clients of these in writing.

Introduction

- 2. SLATs – spousal lifetime access trusts were ubiquitous in 2020-2022 planning and will get a lot more use before the exemption is cut in half in 2026. Many of these plans were rushed to beat proposed legislation that didn't happen. SLAT planning was often done on a rushed basis which may have prevented practitioners from taking or recommending that clients take various precautions to protect the plan. **Action might be warranted to protect the practitioner**. These will be discussed below.
- **Common gaps in that planning, exacerbated by the current market declines and possible recession, present significant opportunities to sell more disability, long term care and life insurance**. There is also a **unique marketing twist** to this opportunity in that **it may help protects the attorneys who created the plans.**
- 3. Anti-Clawback Proposed Regulations – these are complicated but **if you understand what types of estate planning transactions these new rules target, you'll identify a receptive audience to consider insurance planning**. **For practitioners that completed transactions, e.g., a GRIP, that has now been targeted by these Regs, offering options to clients who may lose out may be protective.**

Recent Malpractice Cases Raise Concerns

- Raia v. Lowenstein Sandler, LLP – Thoughts on a Recent Malpractice Case, addressed how Raia served as a catalyst for discussions among advisors regarding a variety of considerations that planners and advisors might wish to consider when engaged in the representation of estate planning clients.
- Wellin v. Nixon, Peabody, LLP: Case Lessons on Defensive Practice reinforced the importance of estate planners reviewing practices, procedures and other considerations when engaged to assist clients with regard to the creation and implementation of a client's planning desires. LISI Estate Planning Newsletter #2934 (January 20, 2022). The issue in the Wellin decision was limited in scope to a determination of whether the statute of limitations should bar the claims alleged. But Wellin also identified issues concerning potential implications resulting from the claimed failure to properly identify, address and potentially have clients waive, inter-generational and spousal conflicts of interest that plaintiffs alleged arose in the course of estate planning. Also, questions were raised as to whether the client was informed of the potential consequences of grantor trusts, and the potential risks of the transaction.

Recent Malpractice Cases Raise Concerns

- Many similar issues are raised in Scott v. Rosen, thereby meriting a further review and analysis of the issues and the potential importance of engaging in defensive estate planning practices. Scott v. Rosen, et al, Broward County docket no. CACE20000868; LISI Estate Planning Newsletter #2979 (August 29, 2022) at http://www.leimbergservices.com.

Insurance Planning May Mitigate Some Concerns Some from Recent Malpractice Cases

- Some of the lessons of the recent malpractice cases include:
  - Put concerns in writing to clients.
  - Inform clients of risks of planning (and all planning has risks).
  - Offer clients options to planning and let the client select the path.
  - Don't over promise results.
  - Avoid using words like "optimal," "best," "maximum," etc.
- Collaborating with other advisers who attend meetings and witness cautions, and explanations of risks, is helpful. Different advisers will also explain planning from a different lens which may help the client understand better what is involved.
- If an insurance professional offers insurance options to mitigate some of the financial risks of a plan, whether the client opts to pursue those or not, that mere offer helps put the client on notice of those risks and may help protect the practitioner.
- This presentation will present three areas wherein insurance consultants might offer such options and perhaps some protection for estate planners.

Insurance Idea #0
(We Just Added This!)
Revitalize Old ILITs

1. **Allocate GST and Decant into SLATs; or**
2. **Sell Policies to SLATs etc.**

Insurance Idea #1
Levine and Split-Dollar Arrangements

Introduction

Introduction to Levine Case

- A recent Tax Court case decision provided **a resounding victory to the taxpayer who had pursued what some might view as an aggressive split-dollar life insurance plan to minimize estate taxes**. Estate of Marion Levine v. Commr,. 158 T.C. -- No. 2, February 28, 2022. **But be careful there are issues! Practitioners engaged in such planning should consider cautioning clients in writing as to risks identified by the Levine court and some of the unfavorable tax consequences.**
- This follows prior cases that indicated problems against other taxpayers who had implemented somewhat split-dollar arrangements, using similar arrangements. Understanding what the taxpayer did right in the Levine case, and how that contrasts to what taxpayers did wrong in a prior case, Estate of Cahill v. Commr, T.C. Memo 2018-84, may provide guidance to can be used to guide taxpayers contemplating such planning or other planning, including the use of FLPs.
- But even better guidance may be possible. A careful reading of the Levine case to identify steps the Levine Court found favorable, might be used to craft a **roadmap of how to implement a similar economic benefit split-dollar insurance plans.**
- **Levine also offers all estate planners a roadmap of how to do any planning safer and better.**

Introduction to Levine Case

Although many view Levine as a major taxpayer victory for split-dollar, it is only one decision of the Tax Court where two prior decisions (Cahill and Morrissette) appear less favorable. And no appeals court has yet to weigh in.

There may be **serious gift tax issues** when entering a split-dollar arrangement which could be viewed as quite negative.

There could also be a **significant income tax consequence in that the value of the receivable is quite low, and gain may be triggered when the receivable is paid.**

Split-Dollar Arrangements

Background

What is Intergenerational Split-Dollar Life Insurance?

- An explanation of what split-dollar life insurance is may be useful. "Split-dollar" is not a type of life insurance. Rather, it is an arrangement under which the proceeds of a cash value policy are split, divided or shared at death and, in some cases, may also provide for a splitting of the cost of premiums on the policy.

- In the family context, split-dollar insurance arrangements are referred to as "private" or "family" split-dollar, in contrast to when the arrangement is used for a key employee (or for a shareholder). See, e.g., PLR 9636033 (not precedent). In a private or family split-dollar insurance plan is when two trusts or persons purchase insurance on the life of a particular family member.

- Typically, when split-dollar is used in an estate plan, an irrevocable life insurance trust ("ILIT") is the owner of the policy. The premiums for the policy involved are often paid by the taxpayer or a proxy for the taxpayer. In the Levine case. the payor of the premiums was a revocable trust established by Mrs. Levine. A similar structure was used in a prior case, Estate of Cahill (which seems to have resulted in a "defeat" for the taxpayer).

What is Intergenerational Split-Dollar Life Insurance?

- The parties to the split-dollar arrangement can agree to allocate policy costs and benefits between them in a variety of ways. For example, in the Levine case, Mrs. Levine's revocable trust advanced the funds for her life insurance trust to purchase policies on her children's lives. And the insurance trust had to pay the trust back an amount equal to the greater of premiums paid or the cash surrender value of the policies on the earlier the insured's death or the termination of the split-dollar arrangement.
- There are two types of split-dollar arrangements: (1) the economic benefit regime under Reg. Sec. 1.61-22; and (2) the loan regime under Reg. Sec. 1.7872-15.
- The prior cases in which the taxpayers lost, Cahill and Morrissette, as well as the current Levine case in which the taxpayer seems victorious, only deal with **economic benefit split-dollar**.

What is Intergenerational Split-Dollar Life Insurance?

- In these types of economic benefit split-dollar arrangements, the insurance trust (ILIT) generally pays only for the term cost of the life insurance which is not material in the early years of the arrangement. Another party, sometimes called the cash value sponsor, such as a family member (often the insureds) or a family trust (e.g., an existing funded marital (QTIP) or dynasty trust) pays the remaining portion, which is generally a significant portion of the insurance cost in the early years of the arrangement. In the Levine case, Mrs. Levine's revocable trust advanced premiums to her insurance trust.

- Note that in the classic economic benefit split dollar arrangement, the cash value **sponsor (e.g., the revocable trust in the Levine case) gets back the greater of premiums paid or cash value**. Of course, before death, cash value may not equal premiums paid. This is the key to the valuation reduction achieved with the plan.

What is Intergenerational Split-Dollar Life Insurance?

- A split-dollar arrangement can potentially accomplish estate planning goals:

1. It may reduce the current gifts the donor/insured is required to make to the ILIT to purchase the desired life insurance. Because Mrs. Levine's revocable trust advanced funds to the ILIT to pay premiums, the ILIT did not need Mrs. Levine to make a taxable gift to it to fund those purchases.
2. It may assure that the insurance proceeds are excluded from the donor/insured's taxable estate. Mrs. Levine never had any interest in the insurance policies involved.
3. The value of the receivable due to the taxpayer (which as stated above is equal to the greater of premiums paid or the cash value of the policy), or in the Levine case Mrs. Levine's revocable trust, might be valued at substantially less than the face value of the monies advanced to the insurance trust. **The $6.5 million advance in the Levine case was valued at about a third ($2.5 million) of that amount as of the time of her death, resulting in Mrs. Levine's estate eliminating 2/3rds of that value from her taxable estate**. That seems to have been a substantial savings. **But do not guarantee any result to the client**.

Be Meticulous in Attention to Detail

- The Levine court recounts in detail the **sophistication of the family, the attention to details in all matters** not only estate planning, the legitimate and substantial business operations and investments involved (not merely a passive securities portfolio as in some bad fact cases), etc. This care and diligence seemed to impress the Levine Court and appears to have given legitimacy and respect to the overall plan. This was significant and is not what occurs in many plans.
- The Levine court noted "estate planners as skilled as the ones the family retained." The Levine Court seems impressed throughout the opinion with the professionalism of how matters were handled. Perhaps this is an indication of how important doing the opposite of what was done in so many bad fact cases is to succeeding in a challenge – be thorough**, adhere to formalities**, etc.

Deliberate Careful Planning

- "*Swanson [the estate planning attorney] spent a good deal of time thinking through all the advantages and disadvantages, conditions and qualifiers. He put together a PowerPoint presentation for the family in late 2007 or early 2008. Then in January 2008 he sent a letter to Larson and the children in which he described the transaction and its legal and tax implications*."
- **Deliberate careful planning, well explained to the client**. Too often this degree of care does not happen, primarily in many cases because clients do not wish to incur the additional fees to permit their advisers to operate in this manner. Perhaps this is all a caution to such clients that being "penny wise and pound foolish" is not the way to handle tax planning. Perhaps advisers should inform clients of the tone and comments in the Levine case to support why deliberate, documented, and thoughtful planning is worthwhile. This type of well documented planning assures the client understands the planning and may protect the practitioner from later claims that the plan or its risks were not explained. Including the entire advisory team: **CPA, estate planning attorney, insurance consultant, wealth adviser, etc. may bolster this.**

Financial Security for Taxpayer

- The Levine Court noted: “From the beginning, Larson [the independent trustee of the ILIT] and Levine’s children made it clear to Swanson [the estate planning attorney] that Levine wanted enough money to maintain her lifestyle until her death. **This meant that any estate planning needed to be done with Levine’s excess capital—i.e., assets that she would not likely need during her lifetime**.”
- **As an insurance professional you can do the models/forecasts to determine “excess capital.” Many estate planners don’t have the skills to do this. This gives you the ability to help on ANY estate plan, not just an insurance plan. This contribution may make the financial/insurance professional an indispensable part of the team. If you have the detailed financial data on the client and create a financial/insurance analysis that illustrates the plan to the client, the client should better understand the plan and some of the financial and other risks of the plan. This is a contribution the Tax Court says is valuable to the success of a plan.**

Decedent Had No Rights

- As of the date of her death, Marion Levine, the decedent, possessed only a receivable created by the split-dollar arrangements. This was only the right to receive the greater of premiums paid or the cash surrender values of the policies when they are terminated.
- **She had no rights on her death or at any time prior to her death, in the life insurance policies held by the ILIT**.
- **She never had any rights to modify or terminate the split-dollar agreement** (that power was vested solely in the ILIT investment committee (insurance trustee).
- The decedent did not have any right, whether by herself or in conjunction with anyone else, to terminate the policies because only the ILIT had that right.
- Contrast in Cahill v. Commr. 115 T.C.M. (CCH) 1463 (2018), the split dollar plan could be terminated during the insured's lifetime by agreement between Survivor Trust and ILIT. This effectively had the son and primary beneficiary of the plan, and his cousin/business partner controlling the decision.

Be Careful that Only the ILIT Ever Owns the Insurance

- The Levine Court stated: "*We find that the "property" at issue cannot be the life-insurance policies, as these policies have always been owned by the Insurance Trust. The split-dollar transaction was structured so that the $6.5 million was paid by the Revocable Trust in exchange for the split-dollar receivable. It was the Insurance Trust that bought the policies and held them. These policies were never owned by the Revocable Trust, and there was no "transfer" of these policies from the Revocable Trust to the Insurance Trust*."

ILIT Decisions By Independent Person

- Larson was the sole member of the investment committee that managed the irrevocable trust.
- **Only Larson, the independent insurance trustee (investment committee) had the right to prematurely terminate the life-insurance policies**. These arrangements gave the other two attorneys-in-fact for decedent no rights to terminate the policies or the arrangement itself.
- Note: This differs from Cahill where decedent/decedent's agents had the right to agree along with an independent trustee of the ILIT to a termination of the split-dollar agreement. This was a critical element of the case that supported the taxpayer victory. But how different in reality was it if Larson was a co-agent and the insurance trustee?

Independent Institutional General Trustee

- South Dakota Trust Company was the general trustee of the trust and was an independent institutional trustee.
- **The use of not just an independent trustee but an independent institutional trustee seemed favorable in the Court's view** of the case. The cost relative to most plans of naming an institutional trustee is quite modest yet many clients resist because of the cost. Again, the Levine case provides confirmation that this step may well be worth the cost involved.
- Many clients prefer the use of family trustees because they will not charge and will accommodate any request. But the latter is exactly what using an institutional trustee may infuse more independence, reality and respect for any transaction. Again, another take home lesson from Levine

Be Certain Person Holding Power to Modify Split Dollar is Fiduciary

- The Levine Court noted: "***The terms of the Insurance Trust expressly state that Larson—in his role as the single-member investment committee—shall be considered to be acting in a fiduciary capacity***…"
- **The fiduciary obligation must be to a distinct/different beneficiary**: "Levine's children are not the only beneficiaries under the Insurance Trust. Her grandchildren are also beneficiaries, and Larson has fiduciary obligations to them as well."

Decedent/Revocable Trust Have No Rights under Split-Dollar Docs

- The Court stated: "*It was very important, if this deal was to work, that the Insurance Trust and not the Revocable Trust own the policies. The* ***recitals in the arrangements state that the parties do not intend to convey to Levine or the Revocable Trust any "right, power or duty that is an incident in ownership*** *. . . as such is defined under Section[s] 2035 and 2042" in the life-insurance policies at the time of Levine's death. They also state that neither the Insurance Trust, nor its beneficiaries, nor the insureds— Nancy and Larry—would have access to any current or future interest in the cash value of the insurance policies. We also specifically find that only the Insurance Trust—and that means Larson—had the right to terminate the arrangements*."
- The Court noted as significant what some might call self-serving statements and contractual restrictions in the split-dollar legal documentation.

Insurance On Lives of Children Made Sense

- The attorney for the decedent identified the "…*children's situation and learned that they themselves also had large real-estate holdings and completely lacked any estate plans. So, he suggested to them and Larson that there just might be a way for Levine to invest her excess capital to provide her with a good return, while at the same time meshing with the Levine children's needs for estate plans of their own*…who themselves have a sufficient net worth to qualify for large life-insurance policies."
- In Footnote 11: the Court said: "…we find him [Swanson the attorney] credible when he said that he also viewed the Insurance Trust as something Nancy and Robert could use in their own eventual estate planning. **Try to have rational business and planning reasons for each component of the plan.**
- This suggests that there was a logical reason to have life insurance on the children's life. Contrast this with the facts in other cases where the purpose of the life insurance may have been viewed as providing a tax savings primarily or even only.
- Unrelated to Levine, insurance consultants should review their client lists and proactively contact G-2 for planning.

#2 SLATs – Spousal Lifetime Access Trusts

Benefitting Grantor's Spouse With Less Issues then a DAPT, and Perhaps No Estate Tax Inclusion

SLATs: How They Work

- Each spouse creates a trust for the other spouse, avoiding the state law creditor and tax **Reciprocal Trust Doctrine**.
- This occurs by making the trusts sufficiently different so the doctrines will not apply.
- The trusts can be created at different times, with different assets and trustees, and with very different terms.
- If the goal is to complete planning before the effective date of any tax law change, that goal may outweigh any benefit of separating each trust's creation by time.
- **Have one trust by life insurance but not the other, or have each trust buy different types of coverage. If one trust buys $5 million whole life and the other trust buys $10 million 20-year term, aren't the economics of each trust substantively different? Doesn't the insurance coverage alone help differentiate the two trusts? If the SLATs were set up last year might a 2022 insurance purchase be considered part of the same plan?**
- **Having an insurance consultant revisit these issues with recent SLAT clients will reinforce the clients understand of the plan and risks in the plan like the reciprocal trust doctrine.**

SLATs: How to Make Them Work

- Create each SLAT in a different state. This is simple with document generation software as you merely select the state for each. (But it likely is best to use only DAPT jurisdictions in case the reciprocal trust doctrine applies.)
- In one trust, the beneficiary spouse can be entitled to distributions each year, have a lifetime broad special power of appointment, can change trustees (within Rev. Rul. 95-58 safe harbor), withdraw under HEMS.
- In the other trust, the beneficiary spouse would have no entitlement to distributions (perhaps is not even a current beneficiary), no power to change trustees, and no power of appointment, but could become eligible to receive a distributions only upon exercise by a trusted child of a power to add beneficiaries. In fact, it may be best for the second trust to be a SPAT.

SLATs: Additional Ways to Provide Grantor Access - 1

- **Do clients have sufficient access to assets in their irrevocable trusts to be comfortable? Have they considered this considering market drops and recession risks? Estate planning attorneys may not have quantified (or even addressed) these issues, but insurance consultants can do so.**
- **Evaluate SLATs/ILITs to determine if adequate access was provided. If not, consider trust protector action, decanting or other steps to enhance access. Consider having forecasts created if that wasn't done when the plan was implemented.**
- **Loans**: Consider granting to someone the power, in a non-fiduciary capacity, to force the trustee to make loans the grantor trust assets. Some might refer to this as a "loan director," but other titles might be used as well. A loan director can determine to loan funds to grantor of the SLAT without adequate security for the loan which will cause the trust to be a grantor trust (but the loan director could be required to charge adequate interest to avoid tax issues). This mechanism provides the grantor another means to access trust assets should the grantor require them.

SLATs: Additional Ways to Provide Grantor Access - 2

- **Charity**: You might also infuse another means of the grantor indirectly "accessing" funds in a SLAT. Give someone, in a non-fiduciary capacity, the power to add charitable beneficiaries. This person might be called a "charitable director," but other titles might be used as well. A charitable director can determine to add charitable beneficiaries to a SLAT. This provides the grantor an indirect means of "access" to the SLAT by making a charitable donation the charitable director can add the charity to the SLAT and the donation can be made out of SLAT funds not the grantor's funds. This too will cause grantor trust status. However, the SLAT should not be authorized to pay a charitable pledge of the grantor.

SLATs: Additional Ways to Provide Grantor Access - 3

- **Vacation Home**: A SLAT could own an interest in a vacation home. And if the grantor's spouse/beneficiary uses the vacation home, the grantor presumably can as part of the spouse's family. Bear in mind if that is to be done with a home in another state, a limited liability company ("LLC") should be formed in the state where the SLAT is governed and administered. That LLC should be authorized to do business in the state where the vacation home is located. That LLC would own the vacation home property and in turn the trust could own some or all of the interests in the LLC. Watch out for Section 2036 and consider that if a home is transferred into the trust if rent should be paid.
- **Income Tax Reimbursement**: If the SLAT is structured to be a grantor trust (i.e., the grantor pays the income tax on trust income) consider including a discretionary income tax reimbursement clause if that will not allow the grantor's creditors access to the trust. This permits the trustee of the SLAT, in the trustee's discretion (it cannot be mandatory) to reimburse the grantor for income tax paid on trust income. A tax reimbursement provision can add valuable flexibility and access to the grantor.

Review Broad Insurance Plan to Backstop 2020-2021 Planning Done in Haste

- Many plans implemented in 2020-2021 were done in haste and without the deliberate planning that would have been ideal had time pressure not existed.
- Disability coverage – review coverage for those with meaningful work expectancy left that transferred significant resources to irrevocable trusts.
- Long term care coverage – review coverage for those who transferred significant wealth to trusts and might be more comfortable knowing they have a plan in place to address care costs.
- Life insurance – to address gaps in SLAT planning (e.g., premature death), and to build a hedge against market volatility.
- Having an insurance consultant review these risks and how insurance pay provide some protection from those risks may document that the client understands these risks and was offered options to mitigate these risks.

Insurance Consultants and Estate Planning Attorneys Can Help Each Other While Helping Clients

- Estate planning attorneys face growing malpractice exposure. Claims are burgeoning. Clients who find they don't have enough resources after funding SLATs and other irrevocable trusts, may well express their disgruntled feelings against those attorneys.
- The reality is that planning was done in such a rush that even if the attorney was sensitive to the economics and insurance aspects of this type of planning, there was inadequate time to address it, as everyone was concerned that the law could change at anytime.
- An insurance/financial professional reviewing financial and insurance projections (or creating them) and insurance protection for SLAT and other irrevocable trust plans may provide important protection for the estate planner even if the client does not buy anything. Why? Because such meetings and analysis may highlight many of the economic risks of these plans and offer solutions. If the client doesn't opt to take those protections, perhaps it is no longer the estate planner's issue.
- Insurance and Financial professionals should educate estate planners, that are not aware, as to the risks inherent in many plans and show how financial planning and/or insurance-based solutions may not only help their clients but protect them.

Should Both or Only One Spouse Fund a SLAT? - 1

- **Example - 1**: Husband and wife have a combined estate of $16 million and are willing to make $8 million in total gift transfers in 2021 to safeguard a portion of their temporary exemptions. If each of husband and wife transfer $4 million to a non-reciprocal spousal lifetime access trust ("SLAT") they will have safeguarded $8 million of exemption (and any future growth on those assets) in case the law changes. In 2026 when the exemption declines by half, to $5 million each (ignoring inflation adjustments) each spouse will be left with $1 million of exemption. So, if you add the $4 million each spouse used in the 2021 planning and the $1 million each has left in 2026, the couple will have preserved $10 million of exemption. Good, but they can do better. If in 2021 the estate tax exemption is reduced to $3.5 million, the couple will have no further exemption left, but they'll be hugging their estate planning for having helped them safeguard $8 million before those changes.
- But then the total exemption safeguarded is only $8 million. Is that optimal? Maybe. But perhaps not. Consider having one spouse, not both, use current exemption thereby preserving more exemption for future planning.

Should Both or Only One Spouse Fund a SLAT? - 2

- **Example - 2**: Assume the same facts as in the above example. Husband and wife have a combined estate of $16 million and are willing to make $8 million in transfers to irrevocable trusts to secure a portion of their temporary exemptions. But instead of setting up two non-reciprocal SLATs as in the above example, the wife gifts $8 million to a DAPT. Her husband and all descendants are beneficiaries of the trust. So, with husband as a beneficiary, so long as he is alive, and they remain married she has indirect access to the $8 million through husband. You could incorporate a mechanism into the trust to add wife in as a beneficiary in the future (see hybrid DAPT below) just in case her husband dies prematurely or divorces. If the exemption drops to $5 million in 2026 as the law currently provides. Wife used $8 million of her exemption so she'll have none left. But, since husband did not use any of his exemption in the plan, he will still have $5 million of exemption left in 2026. So, his $5 million of exemption and the $8 million of exemption the wife used in means the couple has preserved $13 million of exemption, $3 million more than had they used the non-reciprocal SLAT approach in the prior example.

Should Both or Only One Spouse Fund a SLAT? - 3

- If only one spouse creates a SLAT, then the premature death of that spouse creates an accentuated mortality risk for the donor/settlor spouse. Life insurance can mitigate that risk. Thus, when only one robust SLAT is warranted, it may be advisable for the other spouse to create a simple ILIT to own life insurance to protect the donor/settlor spouse from mortality risk.

Life Insurance Planning

Steps to Consider Now for Clients

What Planning Might be Done Before Exemptions are Halved?

- Make transfers to use exemption before it is reduced by half in 2026. **This is on the books now from the 2017 Tax Act not a change Congress needs to pass**.
- Most clients have $360,000 of additional exemption in 2022 from the inflation increase in the exemption from $11,700,000 in 2021 to $12,060,000 in 2022. There will be another bump in 2023 from $12,060,000 to perhaps $13 million. **Contact potential clients to do more planning. The mere bump in exemptions from a year or two of inflation adjustments will support new gifts or perhaps a worthwhile insurance plan.**
- Leverage equity inside ILITs/SLATs to facilitate further planning by beneficiaries. Might an ILIT with a significant cash value policy be able to provide a guarantee to support borrowing? If borrowing is by a beneficiary, no guarantee fee may be necessary. If borrowing is by anyone other than a beneficiary a fee should be paid. If insured/settlor borrows is that an indicia of retaining control?
- Transfers to SLATs, SPATs, DAPTs, etc. may make sense to lock in exemption. Consider the insurance planning below.

Use Gift and GST Exemption before 2026 for ILITs

- Many clients have lots of excess gift and GST exemption but may not wish to make further gifts.
- Some or all the client's remaining gift and GST exemption will be lost in 2026 when the exemption are scheduled to decline by ½. **Use it instead of lose it by improving old ILITs.**
- Many "old-style" ILITs are inefficient/sub-optimal from an estate planning perspective. Many have mandatory payouts to beneficiaries at specified ages (say age 30) and are not GST exempt.
- Consider the following:
  - **Do a late allocation of GST exemption to the old ILIT.**
  - **Decant the ILIT into more "modern" trust that lasts as long as possible under applicable state law.**
  - **This uses GST exemption that might otherwise be wasted and improves the trust.**

Life Insurance Planning in the Current Environment

- It may be a valuable planning step for a client to sell existing personally owned life insurance policies to a grantor insurance trust to remove those policies from their estate before tax laws are changed.
- In some cases decanting (merging) old insurance trusts into the more robust SLATs clients recently created (or selling the policies from the old ILIT to the new SLAT) may be worthwhile. A merger may require a late allocation of GST if the existing/old ILIT was not GST exempt. The result of this planning may be to shift insurance into more modern, protective, GST exempt trusts and perhaps eliminate now unnecessary insurance trusts.

Anti-Clawback Regulations Present Insurance Sales Planning Opportunity

Complicated but an Interesting and Valuable Sales Opportunity

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Clawback as an Insurance Sales Tool

- Some creative planning done in 2020-2022 to safeguard exemption was complicated and recent Proposed Regulations, if enacted, may make those techniques fail.
- Taxpayers who used these techniques, it appears, cannot get their exemption back that they now, assuming the proposed anti-Clawback Regs are enacted, wasted on those planning techniques.
- So, these taxpayers may have little exemption left, and might feel let down by their prior planning (which advisers could not have anticipated without having a crystal ball), and know they will face an estate tax with little to do about it.
- A standard/typical ILIT plan may just solve the remaining estate tax problem some of these clients face, and it may be a comfortable/secure option for them to pursue.
- This stuff is complicated, but understanding what is involved, may give you a substantial sales edge.

Proposed Regs.

- The Treasury recently issued Proposed Regulation Section 20.2010-1(c)(3), that would, if adopted in final form, change rules that are critical to some of the estate tax planning done in recent years to secure the increased but temporary increase in the estate and gift tax exemption equivalent simply referred to as the "exemption" or "exclusion" in this article. The Proposed Regulation is not as harsh as some had feared. Taxpayers who made gifts to spousal lifetime access trusts ("SLATs"), or self–settled domestic asset protection trusts ("DAPTs") that were structured to be completed gift trusts and use the temporary enhanced exemption should not be prevented by the Proposed Regulations from having secured the temporary or bonus exemption amounts (assuming other aspects of the planning are respected). Those common planning techniques have not been attacked in the Proposed Regulation. The Proposed Regulation, however, provides complex rules that will change the anticipated results of several estate tax planning arrangements that had been intended to use exemption.

Temporary Exemption

- Some taxpayers engaged in estate tax motivated transactions to secure the use of the exemption before it is reduced. These taxpayers may have made transfers, often to irrevocable trusts, to endeavor to secure the temporary higher gift, estate, and GST tax exclusions. The Tax Cut and Jobs Act of 2017 ("TCJA") doubled the exclusion amount from $5 million to $10 million, inflation adjusted. Specifically, TCJA amended Code Section 2010 and increased the basic exclusion amount ("BEA") available to decedents dying after December 31, 2017, and before January 1, 2026. Thus, the doubled exclusion sunsets after 2025. The exclusion currently is $12,060,000 and will decline, subject to further inflation adjustments, to $5 million , or approximately $6.5 million with current and anticipated inflation adjustments, in 2026. The broader issue created by the TCJA was whether gifts made using the temporarily increased exclusion before 2026 would be taxed at death if the taxpayer dies after 2025 and the exclusion amount is in fact reduced. The recently issued Proposed Regulation confirms that in most but not all cases such gifts will not be subject to tax by reason of a "clawback" of the exemption. The Proposed Regulation focuses on the exceptions to this rule, i.e., what transactions that may have been tax free when made will trigger an estate tax if the taxpayer/donor dies after 2025.

Example of Painless Transfer Prop. Regs. Seek to Attack

- **Example**: In 2020, taxpayer created an irrevocable, completed gift, GST exempt, grantor trust benefiting spouse and descendants. While the taxpayer wanted to make a gift of $11 million of securities to the trust the taxpayer was too concerned about having access to these assets should they be needed. However, the taxpayer was quite concerned about the tax proposals in 2020 and the possibility of a reduction of the exclusion to $3.5 million. So, the taxpayer made an **enforceable gift of a promise**, a contractual commitment to make a gift, of $11 million. See Rev. Rul. 84-25. The gift was reported on a gift tax return and GST exclusion was allocated under the automatic allocation rules. The taxpayer anticipated, when making the gift, that if the exclusion declined in 2020 from the harsh tax proposals (or in any event knew that it was still scheduled to decline in 2026 to $6.5 million as provided under current law), he or she will have "locked-in" and secured $11 million of the exclusion.

Impact of Anti-Clawback Prop. Regs.

- The feared reduction in exclusions in 2020 did not occur (and while a reduction before 2026 from proposed legislation is possible, it seems that few anticipate that will occur). The anti-clawback rules, which will be explained below, if modified as provided for in the Proposed Regulation, will completely change this result in this planning example. Thus, on the death of this taxpayer, the previous **use of $11 million will not be effective**, and only the new lower exclusion reduced by the exemption used during lifetime will be available. But nowhere does the IRS give back the exemption used on the prior gift tax return! **Are you seeing the possible insurance sale here?**
- This is an exception that the Proposed Regulation would make to the anti-clawback rules.
- There are also, as explained below, two exceptions to this exception that might permit such a "promise to pay" to have secured the exclusion if it is paid at least 18-months prior to the donor's death. The 2nd exception is if the gift taxable portion of the transfer is no more than five percent of the amount transferred.

Impact of Anti-Clawback Prop. Regs.

- This illustrates the types of "gifts" that the Treasury was particularly concerned about. These were gifts which some have referred to as "artificial" or "painless" in that the taxpayer could retain an interest in or control over the assets involved, lock in exemption (at least that is what some practitioners had hoped), and in short have their tax cake and eat it too."
- Other such artificial gift transfers may have included'
  - funding a grantor retained interest trust ("GRIT") to a family member so that the gift would be deemed made of the entire amount transferred with no reduction for the interest retained because, under Internal Revenue Code ("Code") Section 2702 the value of the retained remainder would be valued at zero.

Impact of Anti-Clawback Prop. Regs.

- Gifting a preferred partnership structured that intentionally violated the requirements under Code Section 2701 so that the equity received by the donor in the entity would be valued at zero. The taxpayer could have retained a preferred interest structured so the entire value of the entity would be treated as a gift when certain family members acquired the common interests, thereby securing the use of the gift exemption (and permitting the allocation of GST exemption to the gift). The preferred partnership interest would be included in the taxpayer's estate but the exemption, it was thought, would be preserved.
- The recently issued Proposed Regulations target these type of transactions and endeavor to exclude them from the anti-clawback rule.
- **Insurance planning opportunity – identify clients who made the types of gifts targeted in the Prop .Regs. They will have used up exemption, but the plan won't work if the Prop .Regs. are enacted unless they can unwind the transaction 18 months or more before death.**

Which Taxpayers Do You Target for Anti-Clawback Insurance Sales?

- Many wealthy but not super-wealthy taxpayers struggled with the competing goals of wanting to lock in the temporary high exclusion, but to nonetheless retain control over the assets involved.
- Uber-wealthy taxpayers did not have this issue as they could use all of their temporary exclusion knowing that they had sufficient remaining assets to assure that their lifestyles were protected.
- The response to this was the creation by the estate planning community of several creative approaches to accomplish these contradictory goals. The so-called “promise to pay” gift was one such example. Make an enforceable irrevocable promise to pay that could trigger use of exclusion but, because the donor would not actually transfer any of his or her wealth, retain use of his or her assets.

Which Taxpayers Do You Target for Anti-Clawback Insurance Sales?

- Other creative techniques or variations or new applications of existing techniques were developed to accomplish these same divergent goals. It is these techniques that the new Proposed Regulation attack. That attack is both complex and, as with many new laws, may ensnare other techniques beyond those that might have been intended.
- So, perhaps the **best prospects for targeted insurance sales are moderate wealth say $10-40 million net worth taxpayers (although some at higher levels of wealth with high spending rates may have engaged in this planning as well).**

Another Complex Plan Hit by Prop. Regs. – QTIP 2519 Plan

- In searching for assets that a taxpayer may have been comfortable "parting with," many identified assets in a Qualified Terminable Interest Property ("QTIP") marital deduction trust. First, what is a QTIP?
- A QTIP trust, which may be formed during lifetime (or on the death of the first spouse), to benefit the other (or surviving) spouse, must pay all income at least annually to the beneficiary (surviving) spouse. On the death of the beneficiary (surviving) spouse, the QTIP can specify where the assets are to be distributed. On the gift by the first spouse (or the death of the first spouse) no gift (estate) tax is assessed as the QTIP, if the appropriate tax election is made and the beneficiary (surviving) spouse is a US citizen, and the gift qualifies for the unlimited gift (estate) tax marital deduction. This flexibility to control the ultimate distribution makes QTIPs a useful estate planning tool for "blended" families. The quid pro quo for the deferral of tax on the gift (or first death) is that all income must be paid to the done (surviving) spouse, so the income is included the done (surviving) spouse's estate unless spent, and all the remaining assets on death also are included in the gross estate of the beneficiary spouse.

Another Complex Plan Hit by Prop. Regs. – QTIP 2519 Plan

- If the donee (surviving) spouse relinquishes any portion of the income interest in the QTIP, then under Code Section 2519 he or she will be treated as making a gift of the remainder of the trust and, by reason of Code Section 2702, will be treated as if a gift was made of the entire QTIP trust. That gift deemed so made by the donee (beneficiary) spouse (would use up any Deceased Spouse Unused Exemption ("DSUE") that was "ported" over from the first spouse to die) would use up any of the beneficiary (surviving) spouse's remaining exemption. Because the beneficiary (surviving) spouse could, for example, relinquish just 1% of a portion of the income interest, but still receive 99% of the income distributions, there may be no material economic downside to disclaiming a tiny portion of the income interest. Yet that disclaimer could have used all of the beneficiary (surviving) spouse's remaining temporary bonus exclusion.

Another Complex Plan Hit by Prop. Regs. – QTIP 2519 Plan

- After the beneficiary (surviving) spouse disclaims a portion of his or her income interest in the QTIP trust, the trust property is deemed to be transferred under Code Section 2519. That property will not be included in the beneficiary (surviving) spouse's gross estate under Code Section 2044(b)(2) if the beneficiary (surviving) spouse lives for three years from the date of the disclaimer.
- Under the Proposed Regulations, the lower post-2025 exclusion amount, not the amount available at the time of the earlier gift under Code Section 2519, only will be able to be used by the estate of the beneficiary (surviving) spouse.

Another Complex Plan Hit by Prop. Regs. – QTIP 2519 Plan

- So, anyone who did this type of QTIP/2519 plan to lock in their exemption or DSUE will have used up the exemption so that further planning now may be limited, but these clients will have not preserved the higher exemption as their estate will only get the lower $5M inflation adjusted exemption.
- Identify these prospects and perhaps suggest a life insurance plan to fund what might now be a substantial estate tax their estates will face.
- After feeling let down, perhaps by the more creative prior plan these taxpayers may prefer a more traditional an ILIT.

Conclusion and Additional Information

Uncertainty,
Insurance
Opportunity,
Defensive Practice

Conclusion

- Levine may have **given a recipe for economic benefit split-dollar as a tool to sell more insurance to very wealth prospects**. **But be very careful as the results may not be replicated and there are worrisome tax risks the case did not address.**
- **All wealthy prospects exemption should address planning before 2026. Some clients may opt for insurance and not wish to undertake more complex and costly planning.**
- **Spousal lifetime access trusts (SLATs) and a lot of other wealth transfer planning completed in 2020-2022 present opportunities for insurance planning to fill the economic gaps in such planning: premature death, disability, long term care costs considering the wealth transferred to harder to reach trusts**. **This may also protect practitioners?**

Conclusion

- Estate planning attorneys face increasing risks of malpractice claims. **The analysis insurance/financial consultants do as to how insurance may address gaps in planning may help protect not only the client, but the attorney who orchestrated the planning, from a malpractice claim.**
- **The informed insurance consultant has a unique opportunity to capitalize on the current environment and provide great value to clients.**