PACIFIC LIFE

Four for 2024: 4 Compelling Client Strategies

Bringing You Ideas & Strategies That May Incorporate Life Insurance

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Not FDIC Insured	No Bank Guarantee	May Lose Value

Tax Cuts & Jobs Act (TCJA) – Provisions Expiring at the End of 2025

- **Individual Tax Rates: Top Rate on Ordinary Income returns to 39.6%**
- **State and Local Tax (SALT) cap deductions- $10K lifted**
- **Mortgage interest deduction reverts to pre-TCJA levels**
- **199A Pass through business income tax deduction eliminated**
- **Sunset of Federal Estate, Gift and Generation Skipping Transfer (GST) Exemption**

The Federal Estate Tax Exemption:

Use It or Lose It

What is the potential opportunity?

Individuals may potentially **transfer an additional $6.805M* free of estate taxes** but only if they act before the end of 2025

Married couples may potentially **transfer an additional $13.61M* free of estate taxes** but only if they act before the end of 2025

*As of 2024

Potential Issues to Overcome When Taking Advantage of the Temporary Doubled Federal Estate Tax Exemption

1

It's an "All or Nothing" Proposition: Pre-2026 gifts effectively reduce the post-2025 exemption amount potentially leaving little to no remaining exemption amount after 2025

2

Many wealthy individuals are concerned about giving up control and access to a significant portion of their assets regardless of wealth

1. Spousal Lifetime Access Trust (SLAT)

What is a Spousal Lifetime Access Trust (SLAT)?

ILIT** designed for **married couples**

Married couple **may gift assets** without losing total access

Distributions to spousal beneficiary generally limited to **health, education, maintenance, or support (HEMS)**

Grantor spouse establishes SLAT for **benefit of non-grantor spouse and children**

Grantor spouse makes **separate property gifts to SLAT***

Trustee **may purchase life insurance policy** on grantor's and/or non-grantor spouse's life

Life insurance/assets are outside grantor's estate*

- *According to the Tax Cuts and Jobs Act of 2017, the federal estate, gift and generation-skipping transfer (GST) tax exemption amounts are all $10,000,000 per person (indexed for inflation effective for tax years after 2011); the maximum estate, gift and GST tax rates are 40%. In 2026, the federal estate, gift and generation-skipping transfer (GST) tax exemption amounts are scheduled to revert to $5,000,000 per person (indexed for inflation for tax years after 2011); As of January 1, 2024, the annual gift tax exclusion is $18,000 per donee (indexed for inflation). Rev. Proc. 2017-58.*

***Irrevocable Life Insurance Trust*

Potential Features of a SLAT

Spousal Beneficiary as trustee of the SLAT:*

- greater flexibility and access over the life insurance policy’s cash value/assets through spousal provisions (HEMS)

Each spouse create a SLAT for the benefit of the other spouse (HIS/HER SLATs):**

- helps alleviate concern of the grantor spouse losing indirect access to the funds in the trust

Two potential layers of creditor protection:

- from grantor’s creditors and creditors of beneficiaries

Not naming the spousal beneficiary by name in the trust document:

- may allow new spouse to step in as beneficiary of the SLAT in the event of a divorce or the death of the spousal beneficiary

Include grantor loan provision in the trust:

- alleviates concern of the grantor spouse losing indirect access to the funds in the event of divorce or death of the spousal beneficiary

**If the spousal beneficiary is also the trustee, then his or her discretion as trustee to make distributions to him or herself would need to be limited by what are known as ascertainable standards (health, education, maintenance, and support) in order to avoid inclusion of the trust assets in his or her estate.*
***If each spouse establishes a SLAT for the other spouse, the IRS may apply the “reciprocal trust doctrine.” Under the reciprocal trust doctrine, two identical or substantially similar trusts may be ignored for federal tax purposes. The clients’ tax and legal advisors must carefully consider the reciprocal trust doctrine when contemplating establishing SLATs for the benefit of each spouse.*

Potential concerns/considerations of a SLAT

Spousal Beneficiary as Trustee*

- Power to make distributions to themselves must be LIMITED to reasonable HEMS distribution
- Consider an independent trustee or adverse party as trustee
- Spousal beneficiary, if also an insured, should NOT serve as trustee over the life insurance policy.

Risk of death or divorce of spousal beneficiary

- No longer has indirect access to trust

The reciprocal trust doctrine (HIS/HER SLAT)**

**If the spousal beneficiary is also the trustee, then his or her discretion as trustee to make distributions to him or herself would need to be limited by what are known as ascertainable standards (health, education, maintenance, and support) in order to avoid inclusion of the trust assets in his or her estate.*

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2. Corporate Transparency Act

What is the Corporate Transparency Act ?

Corporate Transparency Act (CTA) aims to combat illicit activity including tax fraud, money laundering and terrorism financing by requiring US entities to report to FinCEN

- Effective January 1, 2024

Entities are required to submit Company and Beneficial Ownership Information (BOI)

- Includes domestic and foreign businesses

Penalties for non-compliance

- Civil penalties ($500 per day)
- Criminal sanctions

What is the potential opportunity?

Provides an **opportunity** to contact clients to **share information**

Reporting requirement exposes ownership/makes ownership **more transparent** (e.g. Foreign Nationals)

Life insurance can provide the **liquidity** to pay estate taxes or debt obligations*

- In general, a foreign national's U.S. estate tax exemption amount is $60,000**
- A life insurance policy held personally by a foreign national on their own life is exempt from income or estate taxes***

**For federal income tax purposes, life insurance death benefits generally pay income tax-free to beneficiaries pursuant to IRC Sec. 101(a)(1). In certain situations, however, life insurance death benefits may be partially or wholly taxable. Situations include, but are not limited to: the transfer of a life insurance policy for valuable consideration unless the transfer qualifies for an exception under IRC Sec. 101(a)(2)(i.e. the transfer-for-value rule); arrangements that lack an insurable interest based on state law; and an employer-owned policy unless the policy qualifies for an exception under IRC Sec. 101(j).*

***In general, a non-resident alien's U.S. estate tax exemption amount is $60,000 and is not indexed for inflation.*

****Life insurance is not considered U.S. property to be part of the estate for estate tax purposes if owned on NRA's own life . IRC Sec. 2105; Treas. Reg. Sec. 20.2105-1(g).*

3. Insured Hybrid Buy Sell:

For Pass-Through Businesses

What is Insured Hybrid Buy-Sell?

A combo of cross purchase and entity redemption agreement (for pass-through business owners)

Takes advantage of both types of buy-sell arrangements

- One life insurance policy per owner because it's funded like an entity redemption (business owns the policies)
- Avoids direct/personal ownership by other individual owners
- Protects from lack of equity of premium payments (age, health, etc.)
- Provides remaining owners with a basis increase

** According to the Tax Cuts and Jobs Act of 2017, the federal estate, gift and generation-skipping transfer (GST) tax exemption amounts are all $10,000,000 per person (indexed for inflation effective for tax years after 2011); the maximum estate, gift and GST tax rates are 40%. In 2026, the federal estate, gift and generation-skipping transfer (GST) tax exemption amounts are scheduled to revert to $5,000,000 per person (indexed for inflation for tax years after 2011); As of January 1, 2023, the annual gift tax exclusion is $17,000 per donee (indexed for inflation). Rev. Proc. 2017-58.*

How Does a Insured Hybrid Buy-Sell work?

An agreement that lays out when a lifetime buy-out takes place or when a buy-out at death occurs

Funded like an entity redemption (business owns the life insurance policy)

If a lifetime buy-out:

- Life insurance cash value* may be used to fund part of the buy-out
- treated like a cross purchase so remaining business owners receive a basis increase
- normal rules that apply to pass through owners

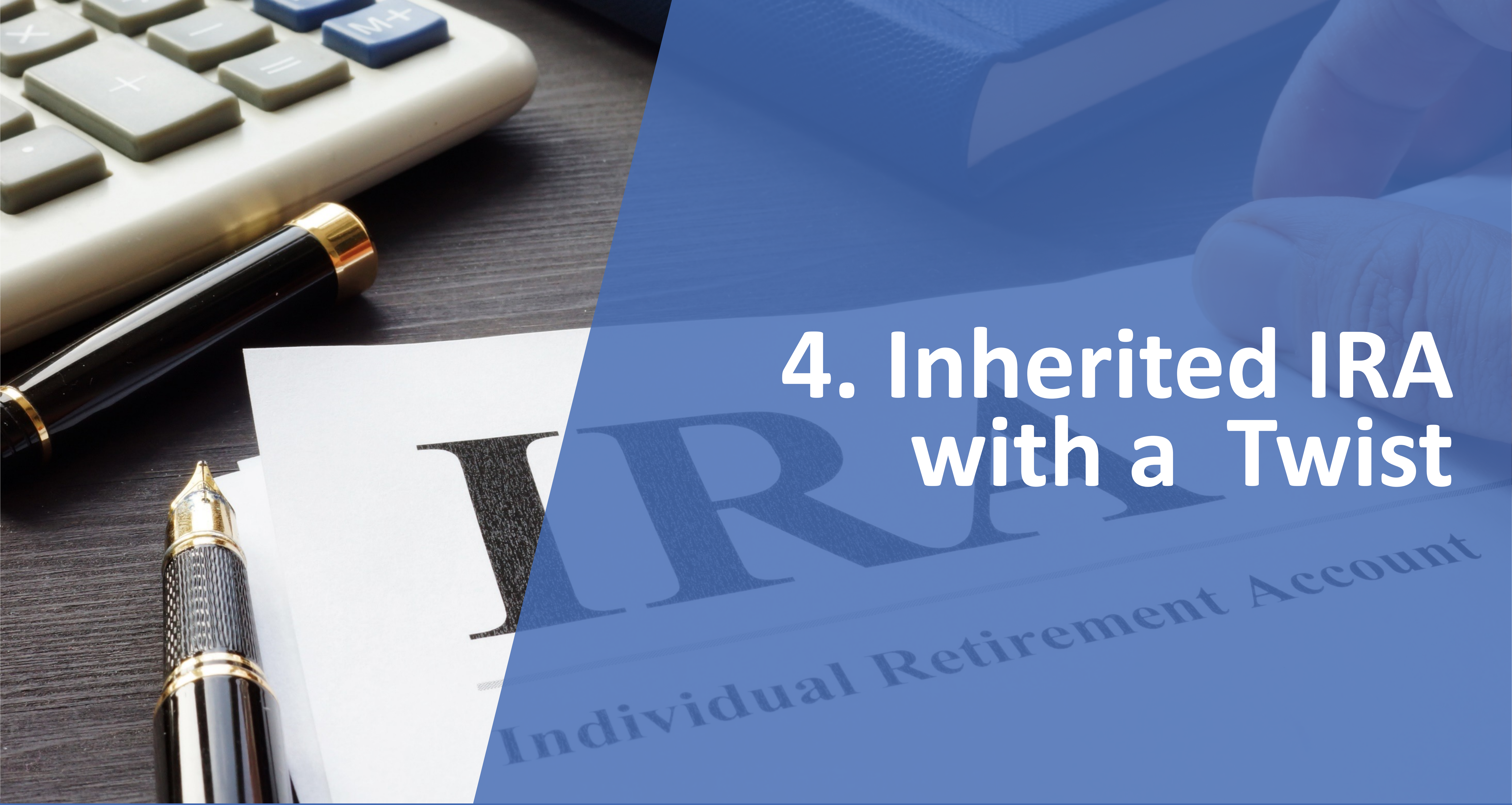
**For federal income tax purposes, tax-free income assumes, among other things: (1) withdrawals do not exceed tax basis (generally, premiums paid less prior withdrawals); (2) policy remains in force until death (any outstanding policy debt at time of lapse or surrender that exceeds the tax basis will be subject to tax); (3) withdrawals taken during the first 15 policy years do not cause, occur at the time of, or during the two years prior to, any reduction in benefits; and (4) the policy does not become a modified endowment contract. See IRC §§ 72, 7702(f)(7)(B), 7702A. Any policy withdrawals, loans and loan interest will reduce policy values and may reduce benefits.*

How Does a Insured Hybrid Buy-Sell work?

If buy-out at death*:

- If S-Corp (using cash basis method), basis increase can be achieved through a short tax-year election
- If LLC or Partnership, basis increase can be achieved through a Special Allocation Provision

**Life insurance proceeds paid to the business may have adverse estate tax. See Connelly v. United States, No. 21-3683 (8th Cir. June 2023); IRC Section 2703 (b).*



4. Inherited IRA with a Twist

Inherited IRA with a twist:

Potential for surviving spouse to do ROTH conversion using life insurance

Example: **Husband & Wife**

- Husband passes away with $1M IRA
- When wife inherits the IRA, it will cost her $400K in taxes to do a ROTH IRA conversion
- Purchase a $400k life insurance policy on Husband, Wife as beneficiary, using distributions from IRA to pay premiums
- At Husband's death, wife receives death benefit* proceeds to use for ROTH Conversion and create a tax-preferred asset

* For federal income tax purposes, life insurance death benefits generally pay income tax-free to beneficiaries pursuant to IRC Sec. 101(a)(1). In certain situations, however, life insurance death benefits may be partially or wholly taxable. Situations include,but are not limited to: the transfer of a life insurance policy for valuable consideration unless the transfer qualifies for an exception under IRC Sec. 101(a)(2) (i.e., the "transfer-for-value rule"); arrangements that lack an insurable interest based on state law; and an employer-owned policy unless the policy qualifies for an exception under IRC Sec. 101(j).

Questions?

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