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Subject: **Life Insurance Planning Opportunities Under New Transfer Tax Provisions of Tax Relief, Unemployment Insurance Authorization and Job Creation Act of 2010**

Major References: [***"Tax Relief, Unemployment Insurance Authorization and Job Creation Act of 2010," P.L. 11-312, Title III, \(December 17, 2010\)***](#)

Prior AALU Washington Reports: 10-135; 10-125; 10-112

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In our earlier Bulletins Nos. 10-135, 10-125 and 10-112, we reported on the "Tax Relief, Unemployment Insurance Authorization and Job Creation Act of 2010," which was signed by the President on December 17, 2010, and particularly on the estate, gift and generation-skipping transfer tax provisions of that statute. In this Washington Report we examine the opportunities offered by the statute for more effective estate, gift and generation-skipping transfer tax planning as a result of the increased exemptions available in the next two years.

In summary, the new law sets the estate and generation-skipping tax exemptions at \$5 million per person and \$10 million per couple beginning retroactively on January 1, 2010. The gift tax exemption (which remained at \$1 million per person (\$2 million per couple) during 2010) is now - during 2011 and 2012 - "reunited" with the estate and GST exemptions at the level of \$5 million person and \$10 million per couple. The exemption amount is indexed for inflation, in increments of \$10,000 beginning in 2012. The bill also imposes a top tax rate of 35 percent during 2011 and 2012 for estate, gift and generation-skipping

transfer taxes. The increases in these exemptions, especially the gift GST exemptions, present new planning opportunities as follows:

Ability to Fund Premium Payments. The ability of the insured to fund large life insurance purchases - particularly of single-premium policies - through gifts to an irrevocable life insurance trust (ILIT) has just increased five-fold (keeping in mind the potential difficulties that may result from modified endowment contract considerations). Where gifts to ILITs used to be limited to the grantor's available "Crummey" demand rights and his or her combined \$2 million lifetime exemption (assuming a married grantor), ILITs can now be funded with up to \$10 million per couple. The ability to make large gifts to ILITs is not just an advantage to the purchase of single-premium policies, however: The ability, in 2011 and 2012, to pre-fund an ILIT to pay for premiums that are due after 2012 (when it is possible that the gift tax exemption will revert to pre-EGTRRA levels) will also be enhanced. This latter advantage should alleviate the concerns of many grantors/insureds who would otherwise be faced with complicated planning to fund such premiums over time.

Leveraged Gifts to ILITs and Other Trusts. Assuming that not all of the grantor's exemption will be needed to pay premiums, the grantor could contribute assets to an ILIT as "seed" money, and thereafter sell assets - which may be family business assets or marketable securities - to the ILIT to generate money to pay premiums and for other purposes. Since the "rule of thumb" for funding trusts to which sales will later be made generally requires a 10-to-1 ratio of seed money to sales price, a \$10 million gift in trust could support a sale of assets with a value of up to \$100 million. In an ILIT, a \$10 million gift could serve both to purchase a large single premium policy, and to finance the purchase of additional assets based on the 10-to-1 leveraging formula. Further, since valuation discounts were not adversely impacted by the new law, as had been feared, the ability to pass on a closely-held family business at discounted values through the use of combined gifts and sales is augmented.

Dynasty Trusts. Many policies purchased by high net worth individuals are purchased in connection with the formation of a multi-generational "dynasty" trust to take advantage of the ability to shield assets from transfer taxes for generations. This advantage is accentuated by the increased GST tax exemption that is available for the next two years. Even though the GST tax exemption may be reduced after 2012, the allocation of up to \$10 million of gift and GST tax exemption in 2011 and 2012 will not be taken away or reduced after 2012, and, if properly structured, the ILIT's assets will not be includable in the estate of a decedent who dies after 2012, even if the estate tax reverts back to pre-EGTRRA levels.

Split Dollar Arrangements. The need for private split-dollar arrangements to finance new (and some existing) policies may decline (at least for the next two years), since many policies may be financed using the enhanced exemptions available in 2011 and 2012. This doubtless will simplify the purchase of a policy as part of an estate plan for many insureds. However, the increased exemptions also may be used to "roll out" or terminate old split-dollar arrangements through gifts to existing ILITs that may be used by the ILIT to repay premium advances in situations where the "economic benefit" makes the continuation of the arrangement untenable.

GRATS. The utility of grantor retained annuity trusts (GRATs) that have been used in the past as vehicles to create a "side fund" to finance the payment of life insurance premiums or to create an exit strategy for split-dollar arrangements will be enhanced by the new law. The law did not prohibit short-term GRATs, or impose a minimum remainder requirement, and GRATs can now be combined with the increased exemptions and other leveraging techniques to generate additional premium payment sources in the next two years.

The foregoing advantages are doubtless not the only ones that will accrue to planning with life insurance as a result of the new law. We stress, however, that there is a relatively short window for clients to take advantage of them and thus for AALU members to assist them in achieving their planning goals.

The new law will sunset on December 31, 2012 unless Congress acts to extend it. After that date, the exemptions may revert to pre-EGTRRA levels and the opportunities presented above may be lost.

Any AALU member who wishes to obtain a copy of the Title III of P.L. 111-312, “Tax Relief, Unemployment Insurance Authorization and Job Creation Act of 2010” may do so through the following means: (1) use hyperlink above next to “Major References,” (2) log onto the AALU website at www.aalu.org and enter the *Member Portal* with your last name and birth date and select *Current Washington Report* for linkage to source material or (3) email Anthony Raglani at raglani@aalu.org and include a reference to this *Washington Report*.

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