



Advanced Markets Blog

## *The Triple A approach to estate planning opportunities*

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In the estate planning community, there was considerable buzz at the end of last year about getting high-net-worth (HNW) clients to make large gifts to irrevocable trusts to utilize their remaining exemptions, with a lot of the commentary centered on a “use it or lose it” mentality. These conversations were largely driven by the assumption that the incoming Biden administration may enact tax law changes that reduce the estate and GST tax exclusion — currently at an all-time high of \$11.7M — to \$3.5M and return the maximum marginal estate tax rate back up to 45%. Adding further urgency to conversation, some planners speculated that tax law changes enacted in 2021 could be made retroactive to January 1.

**Now that 2021 is underway, financial professionals should be wondering a few things:**

- How many of these clients followed through and transferred assets by year-end?
- For those who were on the fence but failed to act, why was that the case?
- And lastly, but importantly, for those who did make gifts, what is the planning team and trustees’ strategy for optimizing those assets now owned in trust?

To answer the first question, I consulted with a few trusted estate planning attorneys. In almost every conversation I had, one common sentiment arose. For HNW clients, including those of different age demographics, political affiliations and with a variety of expressed planning objectives, there was certainly an increased interest in planning. But did they act on plans? In many cases, the answer was, somewhat surprisingly, no.

This left me slightly puzzled. Why would a client — who expressed an interest in planning and taking advantage of the largest estate tax exemptions in history — risk rolling the dice to see what type of tax law changes a new administration might be able to enact?

Heading into year-end, the make-up of the Senate was still unknown, thus uncertainty around the feasibility of significant tax law changes passing may have kept some clients on the fence last year. But another reason, I think, likely comes down to the psychology of making irrevocable gifts.



As numbers-driven financial professionals, we sometimes fall blindly into offering solutions or proposals before knowing what is really driving the client. Before recommending a solution, financial professionals should consider first unpacking what we call the “Triple A” approach to estate planning — the client’s **Age**, the **Assets** they own, and/or their overall **Attitude**, which encompass their perceptions, beliefs and goals. Think about it like this:

**Age:** The perspective of someone in their 30s, 40s or 50s is going to be much different than those in their 70s or 80s. For example, younger clients often cannot fathom locking up significant wealth in irrevocable trusts for their minor children and may have a host of seemingly more pressing priorities than estate and income tax planning.

**Assets:** What type of assets do your clients have? Do they own assets that are difficult to transfer or value and/or have meaning beyond their monetary worth, such as a family business or heirloom property? Lastly, if the client has an insurance need, if transferred, would the asset’s cash flow be enough to pay the premium?

**Attitude:** Age and assets may factor into overall attitude, but can include thoughts like “Do I want to do this? Do I have to do this right now? What factors are impacting my willingness to act (e.g., personal finances, economy, regulatory changes, etc.)? How does my family situation drive my willingness to move forward with plans?”

Let’s look at how the “Triple A” approach can be applied today to steer the conversation to a solution:

### **Scenario 1: Lock-in a plan now with a “wait and see” approach**

With Democratic control of the White House and both chambers of Congress, it appears tax law changes may be imminent. However, the new administration faces a plethora of competing legislative priorities and will be constrained by a narrow Senate majority, thus the timing and extent to which we may see tax law changes enacted are unknown. These uncertainties, among other factors -- such as the clients’ age and stage of life — may result in them being slow to take any action on financial and estate plans while they wait to see what happens.

Combining the low-interest rate environment with life insurance planning could be an effective way to help clients achieve planning objectives today without requiring them to permanently lose control over their assets. The exact financing technique will depend in large part on the assets the clients own — for example income-producing assets may be sold to an intentionally defective grantor trust in exchange for a promissory note, or liquid assets such as cash or securities could be lent to a trust under a private finance loan arrangement. In the former scenario, the promissory note would bear interest at the Applicable Federal Rate (AFR), which continues to be at an historic low — the March long-term AFR has ticked up slightly, but is still just 1.62%.

The trustee can then use the asset’s income to help cover the premiums on a life insurance policy that will be purchased and owned by the trust, funding what could be a substantial death benefit inside of the trust with minimal or in some cases, no gifting required. At the end of the loan term, or sooner if needed, the grantor is repaid and at the grantor’s death, the trust receives the death benefit income and estate tax free. To further increase control and flexibility for married couples, the trust may contain spousal-access language, allowing for the non-grantor spouse to be a beneficiary of the trust.

Why this strategy works now is that not only does it get the insurance in place today, but it allows the client to take a “wait and see” approach as it relates to gifting — in other words, it’s in sync the attitude they hold today to planning, while also considering their assets and factors such as age. If tax law changes appear imminent, the grantor can opt to forgive the promissory note, thus making a gift, and potentially increasing the total amount removed from the grantor’s estate available for legacy purposes.

## Scenario 2: Matching asset type and attitude

For clients with funded irrevocable trusts, there may be an especially unique opportunity to leverage the low interest rate environment and optimize assets that are currently owned in trust. As the trustee decides how to best deploy the assets owned in the trust, one option to consider is how a life insurance death benefit could potentially enhance the overall estate plan. Depending on the client's planning goals and their age and stage of life, the insurance need could be viewed as an additional source of liquidity or for estate-equalization purposes.

In many instances, life insurance can also offer a competitive rate of return and tax diversification. For example, assume a client, male age 60, gifted \$11M of assets to his intentionally defective grantor trust in December 2020. Recognizing the value life insurance encompasses, the trustee purchases a \$20M Protection Survivorship IUL policy with a \$332K premium for 10 years.<sup>2</sup> Using the asset income to pay the premium yields a projected 6.44% IRR at joint life expectancy (age 93)<sup>3</sup> on the death benefit. Assuming the asset generates cash flow of 2% of the trust value (death benefit plus side fund), the trust's value is projected to be \$36M with an 8.66% IRR. If the asset generates a cash flow of 7%, those numbers increase to a \$104M trust value and 12.64% total return to the trust.

Of course, the ability to optimize assets in trust with insurance requires an understanding of what the trustee is working with. Are the assets in the trust liquid, such as securities that pay a dividend? Or are they hard assets that may not produce sufficient income to pay the premium? When the asset does not generate enough income to support the premiums on the policy, financing techniques including premium finance loans from a third-party lender can be explored.

Even if the asset income can support the premium payments, in some cases, the internal rate of return may be boosted by utilizing a financing technique. In the same example above, assume instead that a minimum funded premium finance loan arrangement is entered whereby the loan will be repaid from the asset, or alternatively, a grantor retained annuity trust. Assuming the asset generates cash flow of 2%, the premium finance strategy boosts the projected trust value (death benefit plus side fund) from 8.66% to 9.58% IRR. If the cash flow is 7%, those numbers increase from 12.64% to 14.72% IRR. Because we are not relying on the policy to repay the premium finance loan, risk is reduced.

Another alternative that could work especially well for clients of younger ages and/or those looking to transfer an illiquid asset with a liquidity event in the future could be private split dollar loans with a grantor retained annuity trust.

The key takeaway is not so much about the specific solution(s), but rather establishing the need and goals of the client, and — depending on the client's age, assets, and overall attitude towards planning — recommending tailored solutions. Once those questions are addressed, there are multiple options available to provide flexible solutions. Addressing the “Triple A” can help provide you with a roadmap to offer flexible solutions and uncover insurance planning opportunities.

For more information, please call *Advanced Markets* at 888-266-7498, *option 3 AMC* or *option 4 Attorney*

1. Prior to the sale of an asset to an intentionally defective trust, most practitioners recommend the trust be funded with a “seed gift” equal to at least 10% of the asset transferred.

2. This is a supplemental illustration. Not all benefits and values are guaranteed. The assumptions on which the non-guaranteed elements are based are subject to change by the insurer. Actual results may be more or less favorable.

3. Life expectancy based on 2015 Valuation Table

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The IRR on death benefit is equivalent to an interest rate at which an amount equal to the illustrated premiums could have been invested outside the policy to arrive at the net death benefit of the policy.

Life insurance death benefit proceeds are generally excludable from the beneficiary's gross income for income tax purposes. There are few exceptions such as when a life insurance policy has been transferred for valuable consideration.

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